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Politics this week

May 11th 2006
From The Economist print edition

Reuters

After a poor result for the Labour Party in local elections, **Tony Blair**, Britain's prime minister, sought to reassert his authority by reshuffling his cabinet. Among the changes, he removed Jack Straw from the post of foreign secretary (Margaret Beckett becomes the first woman to hold the job), and sacked Charles Clarke, the home secretary. Mr Blair promised there would be an orderly transition to his likely successor, Gordon Brown. But just not yet. See article

The parliamentary Intelligence and Security Committee concluded that a lack of resources prevented **Britain's** security services from stopping the suicide-bombings that took place in London on July 7th last year. See article

Many European countries expressed concerns over a new **Polish government** that includes two populist parties of the far left and far right. At least the new coalition, unlike the old, will have a parliamentary majority. See article

Vladimir Putin, Russia's president, gave warning of the malign effect of a shrinking population, and suggested measures to raise the Russian birth rate. In his annual state address, he also called for more defence spending, and reproved external critics and enemies.

Nicolas Sarkozy, **France's** interior minister and would-be president, testified to investigating judges in the "Clearstream affair". President Jacques Chirac expressed total confidence in the government led by Mr Sarkozy's rival, Dominique de Villepin, but many saw that as a prelude to Mr de Villepin's departure.

Not so harmonious

The Middle East Quartet (America, the European Union, Russia and the UN) agreed to a still undefined "temporary mechanism" for getting **aid to the Palestinians** while bypassing the Palestinian Authority, now run by the Islamists and sometime terrorists of Hamas. Conditions in the West Bank and Gaza deteriorated further when the Israeli firm that provides the Palestinian territories with fuel cut off supplies because it had not been paid. See article

Violence continued unabated in **Iraq** as the prime minister, Nouri al-Maliki, deliberated on the formation of a new cabinet. In the Kurdish region in the north, two old adversaries, Massoud Barzani and Talal Jalabani, decided to form a joint government.

Iran's president, Mahmoud Ahmadinejad, opened direct communication with America, cut off after Iran's 1979 revolution, with a 15-page litany of grievances and no new proposals to end its nuclear dispute with the UN Security Council. Russia and China continued to hold out against a resolution that would threaten sanctions. See article

After last week's peace deal between the Sudanese government and the main rebel group in the **Darfur** region, America pressed for the UN to send troops to the region as soon as possible. See article

Jacob Zuma, formerly deputy president of **South Africa**, was cleared of a charge of rape by a court in Johannesburg. His reputation has been diminished by some of his testimony in the trial, and he now faces another trial for corruption in July. See article

Heavy fighting in the Somali capital, **Mogadishu,** after the collapse of a ceasefire between rival warlords, left hundreds of people dead and wounded.

The right stuff?

George Bush nominated air-force General Michael Hayden to head the **CIA** after the abrupt resignation of Porter Goss. Many in Congress, including senior Republicans, criticised Mr Bush's choice; General Hayden was in charge of the National Security Agency when a controversial domestic eavesdropping programme was introduced. See article

Mr Bush seemed likely to achieve an extension to his **tax cuts** on dividends and capital gains as Republicans in Congress agreed to a $70 billion package that also delays the imposition of the alternative minimum tax on 15m upper middle-income families.

The Census Bureau reported that the **Hispanic** population in the United States had grown to 42.7m in 2005 and accounted for half of the total growth in population since 2004. Births, rather than immigration, provided much of the increase. The data is more grist for the mill in the debate on illegal immigrants.

Until the pips squeak

Venezuela announced yet another tax increase on foreign oil companies, this one on six firms which have invested $17 billion in extracting 600,000 barrels per day of synthetic oil from the Orinoco tar belt. President Hugo Chávez's government said it would levy taxes and royalties totalling 83.3% on these projects, up from 50.6%.

Óscar Arias took office as **Costa Rica's** president, after narrowly winning an election in February. Mr Arias supports ratification of a free-trade agreement with the United States, but may not be able to secure its approval since he lacks a majority in his country's Congress.

Facing criticism over the nationalisation of Brazilian-operated gasfields in Bolivia, **Brazil's** government inaugurated a uranium-enrichment plant capable of producing nuclear fuel. Brazil has forsworn nuclear weapons. It previously sent its uranium to Europe for enrichment.

Don't change the curtains

Singapore's ruling People's Action Party won a general election for the tenth time in a row. But its share of the vote in contested seats dropped slightly, to 67%. See article

Thailand's Constitutional Court annulled the general election of April 2nd. It is still not clear when a new election will be held, nor what the position of Thaksin Shinawatra, who resigned as prime

minister because of mass public protests, now is. See article

India's Communist parties did well in state elections, winning Kerala and holding on to West Bengal. The Communists support the government, but tend to exercise a block on reform. See article

Reuters

Despite their poor human-rights records, China, Cuba, Pakistan, Russia and Saudi Arabia all won seats on the UN's new **Human Rights Council**. Iran and Venezuela failed to get elected by the General Assembly, while other rights abusers did not even dare try. The United States, which refused to stand, promised to work to ensure the council was effective.

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Business this week

May 11th 2006
From The Economist print edition

Wachovia, America's fourth-largest bank, launched a takeover for **Golden West Financial**, a Californian savings-and-loan, in a deal that Wachovia valued at $25.5 billion. However, Wachovia's share price fell as investors fretted that the bank had paid too much for Golden West in an uncertain housing market. See article

In its biggest acquisition since 2000, **UBS** said it would pay up to $2.5 billion for **Banco Pactual**, a Brazilian equities and investments firm. The move opens Swiss-based UBS to Latin America's growing asset-and-wealth-management market.

NASDAQ further increased its holding in the **London Stock Exchange**, to 24.1%, putting other exchanges that may be contemplating a bid for the LSE on the back foot. Meanwhile, it emerged that French insurer **AXA** has taken a 10.6% stake in NASDAQ, purely for “investment purposes”.

Warren Buffett suggested he would make more overseas deals following Berkshire Hathaway's first non-American acquisition. The investment group bought an 80% stake, for $4 billion, in **Iscar**, an Israeli cutting-tools firm. See article

The domino effect

A bankruptcy judge began hearing **Delphi's** arguments as to why it should be allowed to cancel its labour contracts. Unions are threatening to strike if the auto-parts supplier carries out the move as a step in a wide-ranging restructuring. **General Motors'** chief executive, Rick Wagoner, reiterated that the carmaker badly wanted to settle the dispute, because production would suffer from a strike at Delphi. Meanwhile, GM said regulators had allowed it to revise its accounting of a deal with unions on health care, which reverses its first-quarter loss to a $445m net profit. Investors were happy, boosting GM's share price by 9%. See article

United Airlines'parent company posted a net profit of $23 billion for the first quarter as it discharged liabilities from exiting bankruptcy, without which it lost $306m.

Toyota reported a record net profit of ¥1.37 trillion ($12.1 billion) for the year ending March 31st. Japan's biggest carmaker has seen sales of its vehicles rise in every region of the world (except Japan) and is steadily advancing in the North American market, outstripping Chrysler in April.

Oranges and lemons

Apple Corps, the Beatles' music company, said it would appeal a judge's ruling to allow **Apple Computer** to continue displaying its multi-coloured logo on its iTunes digital music site. Apple Corps, which depicts a green apple as its logo, argued the computer-maker had breached a 1991 agreement that limited the use of each other's symbols to music and computing respectively.

A court in Britain granted **GlaxoSmithKline** an injunction against an animal-rights group that intends to publish personal details of GSK shareholders. The activists threatened the action in letters sent to investors because the drug company uses **Huntingdon Life Sciences**, a controversial animal-testing company.

Two New England-based firms specialising in laboratory services, **Thermo Electron** and **Fisher Scientific**, agreed to merge in a $10.6 billion deal that creates America's biggest supplier of research equipment.

Just a few days after launching a bid, **Macquarie Bank** withdrew from the hotly contested takeover battle for **Patrick**, Australia's biggest cargo handler. **Toll Holdings**, a land-transport and storage firm which launched a hostile bid for Patrick last August, said it would not raise its A$6.2 billion ($4.8 billion) offer.

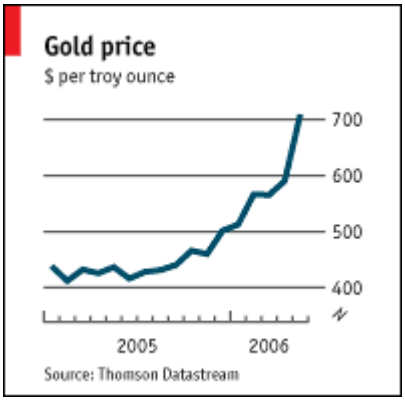
OMV, an Austrian oil firm, is to merge with **Verbund**, a utility, in a combination worth *euro*29 billion ($37 billion). The move, in which Austria's government will swap its 51% stake in Verbund for shares (it also retains a large stake in OMV), comes soon after the country's gas supply was disrupted by Gazprom's dispute with Ukraine.

Lakshmi Mittal said he could reduce his control of **Mittal Steel** and raise the offer for **Arcelor** if the Luxembourg-based firm dropped its opposition to Mittal's bid. The move is the latest shot in a long-running takeover battle.

Speculation grew over the consolidation in Canada's mining industry, as **Teck Cominco** made a C$17.8 billion ($16.1 billion) hostile bid for **Inco**, which in turn said it remained committed to its much-delayed takeover of **Falconbridge**. Others are expected to join the fray.

Pedal to the metal

The price of **gold** continued its relentless ascent and broke the barrier of $700 a troy ounce, less than a month after passing $600. A contributing factor was the weak dollar, which led investors to diversify into precious metals.



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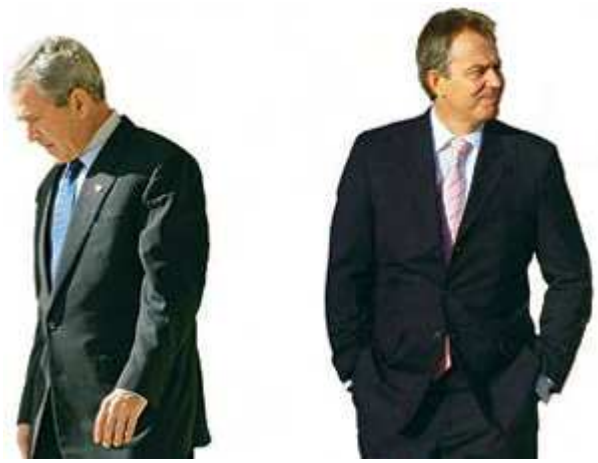
George Bush and Tony Blair

Axis of feeble

May 11th 2006
From The Economist print edition

A world-bestriding partnership is drawing to a close



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THEY have been improbable soul-mates, the silver-tongued British barrister and the drawling Republican from Texas. But the partnership between Tony Blair and George Bush has shaped world events in the nearly five years since the attacks of September 11th. Over the past year, however, the debacle in Iraq and problems at home have turned both leaders from soaring hawks into the lamest of ducks.

This week Mr Bush's popularity drooped to 31% in the polls; his party faces a beating and the possible loss of one or both houses of Congress in November's mid-term elections (see article). In Britain meanwhile, much of the Labour Party, which Mr Blair reinvented and led through three consecutive election victories, wants to bundle its saviour into retirement and replace him with Gordon Brown (see article and article).

Neither man is going right away. Mr Blair may hang on for another year. Unpopular lame duck though he may be, Mr Bush will stay in office until January 2009. And the path may not be all downhill: the dysfunctionality of the Democrats may yet let the Republicans limp home in the mid-terms. But an era is plainly drawing to an end. No matter how long they remain in office, the self-confident and often self-righteous political partnership that shaped the West's military response to al-Qaeda and led the march into Afghanistan and Iraq is now faltering. What does this mean for the wider world?

Remember first that this is no pairing of equals. Britain's contribution to the war on terror has been smaller in substance than in symbolism. After September 11th Mr Bush did not need Mr Blair

in order to mobilise the domestic support and military power he required for his invasions of Afghanistan and Iraq. But in Mr Blair the president found a supreme political salesman and a dependable ally with a respected voice inside both the UN Security Council and the European Union. Better still, Mr Blair was a true believer, exuding conviction. He attached himself to Mr Bush out of principle, not some British instinct to hold the coat-tails of the superpower. From the start, he believed in a forceful response to terrorism and the need to rid Iraq of Saddam Hussein. As a "progressive" politician from the centre-left, who had got on just as well with Bill Clinton, Mr Blair reached audiences in parts of the world, and of America, that Mr Bush could not reach.

Because Britain is so much the junior partner, neither Mr Blair's new weakness nor his possible ejection from Downing Street will have an immediate impact on America's behaviour in the world. Mr Brown has so far given few clues about his beliefs in foreign policy beyond the fact that he is a Eurosceptic well-disposed to America. Under him Britain will continue to value its transatlantic alliance, not least because the European Union has been at sixes and sevens since the voters' rejection of its new constitution and no longer exerts much of a tug in the opposite direction. The timetable for extracting Britain's small force from southern Iraq, Britain's commitment to peacekeeping in Afghanistan and its opposition to Iran's nuclear programme will almost certainly not change.

Even so, as Mr Blair loses authority at home—and even more when he eventually leaves office—Mr Bush is bound to feel the loss not just of a strong ally but also of a kindred spirit. Growing friendlessness at home will be compounded by increasing loneliness abroad. Lately the president has found a new European friend in Angela Merkel. Germany's chancellor is much closer to Mr Bush's way of thinking than was her predecessor, Gerhard Schröder. She is commendably outspoken, for example, on Iran's nuclear programme and its threats against Israel (though also somewhat feeble in her attitude towards Vladimir Putin's increasingly pushy Russia). But many of Mr Bush's other foreign allies, such as Spain's José María Aznar and Italy's Silvio Berlusconi, have lost their jobs. And none of these allies formed a bond as strong as the one with Mr Blair. When the time comes for Mr Bush to soldier on without his one foreign soul-mate and confidant, it may not be Britain's troops, intelligence advice or Security Council votes he will miss most but the psychological pattern of mutual encouragement: each man's reinforcement of the other's belief in the rightness of his gut convictions.

The long shadow of the 1930s

The fact that the prime minister and president hail from opposite ends of politics has made this pattern all the stronger. What they shared was the same instinctive responses to the attack on the twin towers and all that followed. Both have a strong Christian morality. Both see jihadist terrorism and nuclear proliferation as dangers akin to those posed by Hitler in the 1930s. Both consider it their calling to rise Churchill-like to the challenge. Mr Blair may not have gone so far as Mr Bush in defining his as a wartime administration. But part of the Blairite worldview is that desperate times require desperate measures. Even before September 11th, Mr Blair was citing Rwanda and Kosovo as justifications for a doctrine of liberal interventionism under which great powers had a duty to use force for virtuous ends even without the say-so of the United Nations. On September 12th the prime minister sent the president a five-page memo promising to help with the invasion of Afghanistan. This prime minister is as close as any British Labour leader can come to being an American neo-conservative.

With Mr Blair weakened and his own political capital trickling away, Mr Bush will find it harder to trust his own instincts, let alone rise Churchill-like to the challenges in the remaining two and a half years of his presidency. Critics of the improbable partnership—those who think Mr Bush and Mr Blair overreacted to September 11th, lied their way into Iraq, trampled over law and liberties and inflamed the very clash of religions that Osama bin Laden was so keen to ignite—will rejoice.

In a world of one superpower, some say, people are safer when its president is too weak for foreign adventures.

They are wrong. That Mr Bush has made big mistakes in foreign policy is not in doubt. He oversold the pre-war intelligence on Iraq, bungled the aftermath, betrayed America's own principles in Guantánamo and Abu Ghraib, ignored Mr Blair's pleas to restart peace diplomacy in Palestine. But America cannot fix any of these mistakes by folding its tents and slinking home to a grumpy isolation. On the contrary. In his belief that America needed to respond resolutely to the dangers of terrorism, tyranny and proliferation, Mr Bush was mainly right. His chief failures stem from incompetent execution.

What is required when Mr Bush's term ends is a president no less committed to the exercise of American power when it is necessary, and no less willing to rise to external threats. Perhaps that will be a John McCain or a Hillary Clinton. But in the meantime, the world won't wait. However weak he is at home, Mr Bush still has duties abroad. He must ensure that America is not bundled out of Iraq before its elected government has a chance to stand on its own feet. He must hold the line against a nuclear Iran. He needs to push harder for an independent Palestine, continue the fight against al-Qaeda, resist Russia's bullying of its neighbours and help America come to terms with a rising China. If he is wise, he will work harder than before to enlist allies for these aims, even if America must sometimes still act alone. But it will be harder and lonelier without a confident Tony Blair at his side.

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Information technology

Is Google the new Microsoft?

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In some ways, yes—but the differences matter more

JUST AS human history has been shaped by the rise and fall of successive empires, so the computer industry has, in the few decades of its existence, been dominated by one large company after another. During the mainframe era, IBM wore the crown. But it fumbled the transition to smaller machines in the personal-computer era, and the throne was usurped by Microsoft. Now, at the dawn of the new era of internet services, Google is widely seen as the heir to the kingdom. As the upstart has matured into a powerful industry giant, the suggestion that “Google is the new Microsoft” has become commonplace in computing circles. Is it true?

The comparison is both a compliment and a reproach. It is a compliment because it implies that Google has now become the company that defines the environment in which other technology firms operate, just as IBM and Microsoft once did. As with Microsoft in its heyday, Google is the technology firm where the smartest geeks aspire to work; it embodies the technological zeitgeist; and it is a highly regarded company that has become a household name. But the comparison is also a reproach, because it highlights growing concern that Google is now too powerful for its own good, or that of the industry, or indeed that of the world at large.

For many people, Google provides the front door to the internet. For many online businesses, their position in its search ranking—the workings of which are a closely guarded secret—is a matter of life or death. Too much power is thus concentrated in Google's hands, say critics, including Microsoft's Bill Gates. Microsoft and other big internet firms, including eBay, Amazon and Yahoo!, are now said to be negotiating various alliances in order to provide a counterweight to the new behemoth. Smaller firms feel even more vulnerable. As soon as Google says it is moving into a particular market, small fry in that market now dart for cover, unless they are lucky enough to be acquired by Google.

It is not just a matter of business. Google irreparably damaged its reputation with the more idealistic geeks in January when it set up a censored version of its search service for Chinese users. Caving in to the Chinese government, argued Google's critics, made a mockery of its corporate motto, “don't be evil”. Having started out as nothing more than a search engine,

Google's ever-greater ambitions—augmented by a range of new initiatives unveiled at its annual media day this week—now make it seem both creepy and incoherently sprawling (see article). A similar fate befell Microsoft.

Spot the difference

Yet there are some crucial ways in which Google differs from Microsoft. For a start, it is a far more innovative company, and its use of small, flexible teams has so far allowed it to remain innovative even as it has grown. Microsoft, in contrast, has stagnated as a result of its size and dominance. It is least innovative in the markets in which it faces the least competition—operating systems, office software and web browsers—though it is, curiously, still capable of innovating in markets in which it has strong rivals (notably video gaming).

More important, however, are the differences that suggest that Google will not be able to establish an IBM- or Microsoft-style lock on the industry. IBM's dominance was based on its ownership of the proprietary hardware and software of its mainframe computers. In the PC era hardware became a commodity and Microsoft established a lucrative monopoly centred on its proprietary operating system, Windows. But in the new era of internet services, open standards predominate, rivals are always just a click away, and there is far less scope for companies to establish a proprietary lock-in.

Try to avoid using Microsoft's software for a day, particularly if you work in an office, and you will have difficulty; but surviving a day without Google is relatively easy. It has strong competitors in all the markets in which it operates: search, online advertising, mapping, software services, and so on. Large firms such as Yahoo!, which previously farmed searches out to Google, have switched to other technologies. Google's market share in search has fallen from a high of around 80% to around 50% today. Perhaps the clearest evidence that Google's continued dominance is not inevitable is the fate of AltaVista, the former top dog in internet search. Who remembers it today?

Without a proprietary lock-in to protect its dominant position, Google will have to work hard to stay on top. And that, ultimately, is where the comparison with Microsoft breaks down. Google may be the nearest thing to the new Microsoft of the internet era, and the two companies clearly regard each other as their main rivals. But one of the best things about the internet age is that it may well not end up being dominated by a single, Microsoft-like giant at all.

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Monetary policy

Imperfect foresight

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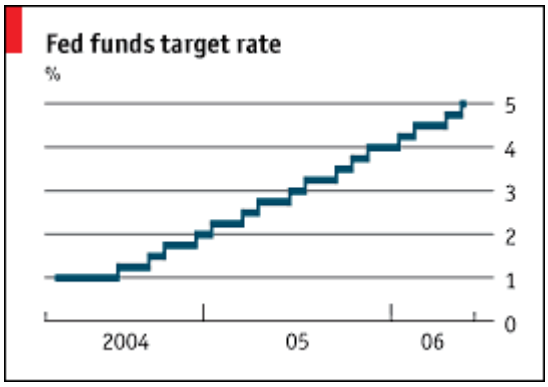
Why a little unpredictability in central banking is no bad thing



IDEALLY, according to the governor of the Bank of England, monetary policy should be “boring”. And for most of the past couple of years it has been. The decisions of the world's top central banks have been utterly predictable. Now, though, things are becoming less routine—exciting, even. For central banks and those watching them, this may be no bad thing.

This week America's Federal Reserve raised interest rates by a quarter of a percentage point for the 16th meeting running, to 5%. Now, though, financial markets are not at all sure where the Fed will go next: it says that “further policy firming may yet be needed”, but that does not look certain (see article). The European Central Bank (ECB), which ended more than two years of inactivity last December, has been broadcasting further rate increases, but no one knows how far or fast: a quarter-point in June, or a half? And markets are waiting to see how the Bank of Japan (BoJ) will feel its way to higher rates, after five years at zero.

This uncertainty about the path of policy has had the markets in a bit of a lather. A fortnight ago they saw in congressional testimony by Ben Bernanke, the Fed's new chairman, a hint of a pause after this week's meeting; Mr Bernanke later told a journalist that this reading was too doveish. Some ECB-watchers have been confused too. Last month Jean-Claude Trichet, the bank's president, pointed to a rise in June but not May; but as strong data rolled in, a few economists wondered whether rates might go up sooner after all. They didn't; and some now think they might rise by half a point next month.

You might conclude that central bankers are struggling to communicate with markets. They are, but not because of any great failing on their part. Their plans are less predictable because their decisions are not as easy as they were a few months ago, especially in America. The recent past has been unusual in that the Fed has clearly been shifting, step by step, from an extremely easy policy towards a neutral one. Now it is more or less there, what happens next? Most economists think the American economy will slow in the second half of the year; failing that, the Fed may have to tighten again. If it's not clear whether Mr Bernanke was signalling a pause, that may be because, quite sensibly, he hasn't yet made up his mind.

Clear and credible

Rather than worrying about being predictable—indicating to markets precisely what they are going

to do next—central bankers ought to worry about being transparent—explaining how they think and why they choose their policies. In the past couple of years it has been unusually obvious what central banks should do. It has therefore been plain to markets what they would do. Now that the view is a little blurred, the way central banks explain themselves will matter more.

The Fed, the ECB and the Bank of Japan all have work to do. Explaining yourself is much easier when you have an explicit policy framework, such as an inflation target, but it is still not easy. The BoJ has a new framework, but it is untested. The ECB has a clear strategy, but is too coy about the discussions behind its decisions. The Fed's approach is implicit rather than explicit—which partly explains the Fed-watching industry's obsessive deconstruction of every official utterance.

Central banks face a dilemma in talking to markets. Predictability makes policymakers credible; and yet markets should form their own view of the economy and hence what central banks should do, or else the central bank looks to the market for guidance only to find its own opinions mirrored. Unpredictable times ought to ease this dilemma—as long as central banks explain themselves and markets listen and think.

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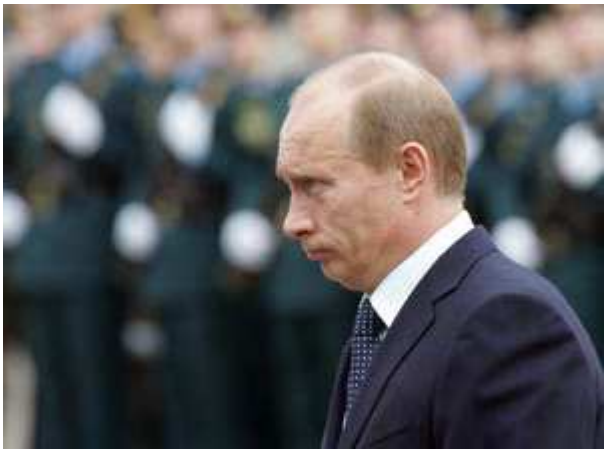
Russia and the West

In search of a Putin policy

May 11th 2006
From The Economist print edition

How to respond to a regime that is simultaneously assertive and paranoid

Reuters



Get article background

THROUGHOUT its turbulent history, Russia has been prickly. At various times it has bullied, invaded or fought against almost all its neighbours. Yet at the same time it has demanded to be treated with respect, as a great power with a rightful place in the high chancelleries of Europe and the world. And for that reason, it has been surprisingly sensitive to outside criticism.

In his annual state address this week, President Vladimir Putin inveighed against those who clung to an era of global confrontation, and against enemies who would weaken his country. This followed the furious reaction in Moscow to last week's speech in Vilnius by Dick Cheney, in which the American vice-president criticised the Russian government for restricting the rights of its own people, interfering in neighbouring countries and exploiting its oil and gas reserves as tools for intimidation and blackmail. The Russians indignantly reject such charges; some even talk of a revival of Russophobia.

Many Russians also accuse the Americans of hypocrisy. The United States uses energy as a political tool, it influences and even invades other countries, its criticism of Russia is not matched by attacks on other autocratic governments such as Azerbaijan's or Kazakhstan's. A lot of Europeans share these criticisms, and they also question the wisdom of provoking Moscow when not only is their energy dependence on Russia increasing, but the West needs its help over Iran.

Given these reactions, it is worth emphasising that Mr Cheney's analysis was spot on. Admittedly, not everything has gone wrong in Russia. Thanks in good measure to high energy prices, the

economy is growing fast and living standards are rising. Mr Putin still seems popular with ordinary Russians, who like the stability he has brought (though most see and hear only what the Kremlin wants them to). A respectable case can also be made for raising Russian gas prices to wean its near neighbours off their Soviet-era subsidies.

Living with a bear

Yet it is clear that Russia under Mr Putin has moved sharply away from the chaotic but recognisable democracy that he inherited, and towards a centralised and intolerant autocracy that stamps on the merest hints of independent opposition. The country is also drifting into a resurgent form of virulent nationalism, with a nastily racist edge to it (see article). Russia's bullying of small fry such as Georgia or Moldova continues apace. And it is pursuing an overt agenda of divide-and-rule when it comes to reminding both its near neighbours and the big countries of western Europe of their dependence on imports of Russian gas.

The real question for the West should no longer be: is Mr Putin's Russia heading in the wrong direction—for the answer is unarguably yes. Instead it should be: what can we do about it? One answer may be “not much”. Russia no longer needs the West's economic and financial help, as it did in the Yeltsin years. It is not going to shed its new-found self-confidence and assertiveness just because of a few speeches.

Even so, as his address this week confirmed, Mr Putin is by no means impervious to outside criticism. He is more likely to be impressed if such criticism is unanimous. Over the past five years disappointingly few European leaders have spoken as forthrightly as Mr Cheney did—indeed, nor has Mr Cheney's boss, George Bush. Worse, several countries have connived in Russia's divide-and-rule approach—notably Germany, which even under its new chancellor, Angela Merkel, has been far too keen on bilateral deals, such as the building of a new under-sea pipeline, heedless of the concerns of its nearest eastern neighbours. If western Europeans are to counter Russian aggressiveness over energy, they must present a united front: for example, by making clear that, should the Russians ever threaten to cut off energy supplies to individual countries, including former parts of the Soviet Union that are not yet in the European Union, their western friends will step in to help.

Should tougher sanctions be wielded, such as boycotting the G8 summit in St Petersburg in July, or obstructing Russian membership of the World Trade Organisation? No, for any such threats would serve only to encourage the paranoid view of some in the Kremlin who believe that the West will always be their enemy. The right approach is to engage constructively with Russia while not being afraid to criticise it—and to try hard to persuade the Russians that the West can be a friend, not an enemy, if only their country resumes its path towards being a properly functioning democracy.

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Darfur

Now seize the moment

May 11th 2006
From The Economist print edition

The sooner a UN force arrives in Darfur, the fewer people will die

EPA

Get article background

AS PEACE agreements go, this one was less than ideal, but certainly better than nothing. After almost two years of painfully slow negotiations, and at the last minute, a deal was struck in the Nigerian capital, Abuja, on May 5th between the Sudanese government and the largest rebel movement active in Sudan's vast western region of Darfur.

This agreement followed heavy pressure exerted on both sides by African, American and British negotiators. But even with all the pressure, two other rebel groups still refused to sign. That testifies to the continuing distrust between all the rebels and the Islamist government in Khartoum. Because of this, a peace of paper may not mean anything very much to either side's fighters on the ground. But the agreement does represent a breakthrough in one vital respect. It provides a diplomatic opening through which the UN should now hurry to send a stronger, better-armed peacekeeping force into the region, to take the place of the weak African Union force already there. That would give the wretched people of Darfur their best chance for years of an end to their nightmare.

The dimensions of the misery are staggering. Kofi Annan, the UN secretary-general, recently called what was happening in Darfur an “inexcusable tragedy”. The Americans, invoking the memory of the horrors of Rwanda a decade ago, have less coyly called it a genocide. Since the mainly African Muslim rebels took up arms in 2003, in protest against what they felt to be years of discrimination and neglect at the hands of the Arab Muslims in Khartoum, as many as 300,000 civilians have been killed and a further 2m or more forced to flee their homes. They have not been safe even in their pathetic refugee camps, many of which have been raided and burnt. A brutal

and ill-disciplined government-backed militia, known as the *janjaweed*, has done most of the killing on a scale that dwarfs even the sectarian slaughter in Iraq.

Last week's is not the first attempt to end the fighting. A ceasefire of sorts was declared in 2004. But it fell apart last autumn and since then the killing, plunder and ethnic cleansing have resumed. Lately the conflict has spilled into Chad, Sudan's western neighbour, destabilising that country as well. To their credit, the member states of the African Union have done what they can to help by deploying some 7,000 peacekeepers to the troubled region. But this small force is poorly equipped and lacks both the numbers and the mandate to impose its will. The government in Khartoum has anyway gone out of its way to hobble its operations—for example by delaying for months the delivery of a few armoured vehicles.

The desperate need in Darfur now is for a force of perhaps twice that size, armed with a permissive mandate from the UN and with properly trained and armed soldiers at its disposal. For all its fragility, the Abuja agreement suddenly makes the insertion of such a force look feasible. The government in Khartoum has long argued that it would allow UN peacekeepers to enter its territory only after reaching a peace agreement with the rebels. Now it has one. Seizing this opportunity, George Bush has already asked the Security Council to pass a resolution that would permit the deployment of troops with a mandate to enforce the Abuja deal.

Not just white faces, please

Speed is of the essence. The sooner a UN force arrives in Darfur, the fewer people will die; it is as simple as that. One job for such a force must be to ensure that the *janjaweed* are indeed disarmed in accordance with the Abuja agreement. If they are not, the agreement will collapse and the precious opportunity the diplomats managed to lever open last week will swiftly slam shut.

Who, though, will provide the soldiers? The most capable troops to hand are those of NATO. Its men and machines may well have to provide the logistical backbone of any enlarged force. And Europe should certainly be willing to help stop a potential genocide. But the prospects for ending the slaughter will be smaller if this is seen by Sudan's people as yet another encroachment by white Christians into an Islamic land. For that reason it is essential to include more African and Muslim troops prominently in the mix. The African Union is already doing its bit. More blue helmets may become available as the UN's peacekeeping operation in Congo winds down after July's election. But what about the Arab League? To date, its members have shown remarkable indifference to the ethnic cleansing taking place in the territory of one of its members. Now would be a good time to make amends.

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Poland's new government

The trouble with Poland

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A country that thrives despite its governments

Reuters

Get article background

SEEN one way, Poland is a dreadful example of how central Europe is going wrong. The largest post-communist country in the European Union has remarkably high unemployment (18%), a remarkably bad system of public administration and some remarkably odd politicians.

Some of the time Poland has been governed by suave but sleazy ex-communists. At other times—including now—it is run by prickly, eccentric anti-communists. The biggest ruling party, Law and Justice, has decidedly rum notions. It loathes gays, feminists and the secular liberal order that most of Europe equates with modernity. On foreign policy, the party's sentimental attachment to America is matched by a visceral loathing of both Germany and Russia (recently the defence minister, Radek Sikorski, likened a German-Russian gas pipeline that Poland opposes to the Nazi-Soviet pact of 1939).

The government formed last weekend is even odder than the minority conservative administration of the past six months. Law and Justice has brought in two populist parties, the left-wing Self-Defence, and the right-wing League of Polish Families. In most European countries, such outfits would be on the fringes, not at the centre of power. Both parties have thuggish streaks, dodgy connections and peculiar ideas about politics and economics (until recently, Self-Defence wanted to cure unemployment by splurging the central bank's foreign-currency reserves). All this seems dismal to Poland's EU partners, who want a calm neighbour that plays by the rules. Instead they see a cranky, unpredictable country that reeks of backwardness; its cut-rate workers destabilise domestic labour markets; its bureaucrats can't implement the EU's rules; and its leaders make sensible decision-making impossible.

Yet as our survey this week argues, this picture of Poland is misleading. The main story of the past 15 years is of stunning success and modernisation. Poland's booming service industries are unrecognisable compared with the exhausted rust-belt country of 1989. Exports are soaring. Economic growth, running at 5% or so, puts old Europe to shame. Even the emigration of a million-odd Poles has its upside. It is better to wash dishes in London than to be jobless at home. Many Poles abroad are learning new skills, languages and attitudes that will stand them in good stead when they return, as most do. Freedom of movement inside the EU means that, unlike previous generations, most Poles are not emigrating for ever.

Nor is Poland's foreign policy as objectionable as some aver. Like its Baltic neighbours, Poland has reason to be suspicious of Russia, over both its aggressive energy policy and its baleful influence in Belarus and elsewhere. Poland is certainly increasingly assertive within the EU—but hardly more so than Spain, a comparably big country. The idea that new EU members from central Europe should be eternally grateful suppliants in the corridors of Brussels is patronising and unrealistic.

Even the latest coalition government may be less bad than it seems, for all the opprobrium deservedly heaped on its smaller parties. The prime minister, Kazimierz Marcinkiewicz, has confounded critics by making his minority government both effective and popular. Reforms in state administration—particularly the legal system—are proceeding apace. Armed with a parliamentary majority, his government could do still more. And it may be better to have populists of left and right tied down within the government than sniping from outside.

But this is still only a second-best outcome. Best would be a coalition that united Law and Justice with the country's other centre-right party, the more liberal-minded Civic Platform. It is baffling that two parties which share so much history and have such similar views are now at odds thanks to personality clashes. Mr Marcinkiewicz and his colleagues in Law and Justice should give their new coalition a chance. But if the populist parties start demanding more than cosmetic changes to economic or foreign policy, they should be thrown overboard without further ado. Poland has done well despite its bad governments. It could do even better with a good one.

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On Zacarias Moussaoui, Europe, Paul Tagliabue, Azerbaijan, Singapore, oil, Africa, investments, marijuana

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Judging terrorists

SIR – Even though Zacarias Moussaoui's tortured prosecution took years and ended somewhat inconclusively, his case illustrates the value of trying suspected terrorists in a federal civilian court ("The one who got away", May 6th). Criminal prosecutions in an open court enable America and the world to see and understand that the United States honours the rule of law by extending the full panoply of constitutional rights to individuals charged with terrorism. Moreover, civilian trials also permit those who stand accused to conduct a thorough defence in public against the state's ultimate sanction and to be judged by a jury comprising members of the community. Such trials stand in marked contrast to those held in other venues, namely military tribunals, which are characterised by truncated procedures, few rights and secrecy.

Carl Tobias
Professor of law
University of Richmond
Richmond, Virginia

Europe's problems

SIR – I can only put your recent trend of Europe-bashing down to a misguided sense of patriotism ("Another great week for Europe", April 15th). It is true that Europe's economies will have to become more liberal to keep growing, but your claim that the continent is facing economic meltdown is ridiculous. As you rightly say, most Europeans are averse to reform because life is good. And considering the gross imbalances between high- and low-earners in America, most people would consider marginally slower growth as a small price to pay for more equality (America has a higher growth rate than France because the French take more holidays). Is it really so hard to envisage European social democracy as a viable alternative to American market fundamentalism? Moreover, it is doubtful if market reform will be the silver bullet to end such problems as a divided north-south economy in Italy and the loss of competitiveness in Europe's textile industry due to the rise of Asia.

Peter Vassallo
Iklin, Malta

Running man

SIR – The remark that Paul Tagliabue, the National Football League commissioner, "cannot run,

catch or throw with any grace" must be based on his reputation as an überlawyer ("In a league of its own", April 29th). "Tag" played basketball for Georgetown University displaying balletic grace in running, throwing, catching and, most importantly, rebounding.

Robert Harley
New York

No comparison

SIR – Considering the vastness of the Eurasian continent, bundling Azerbaijan and Belarus together is as random as it gets ("Use a long spoon", April 29th). Our countries do have a common Soviet past (which is true of many other countries in the region), but that's about it. For some in Moscow the different parts of the former Soviet empire may still look the same, but why you would want to follow that view puzzles me. Moreover, and contrary to what you say, the visit by Ilham Aliev, Azerbaijan's president, to Washington, DC, was a success and good for both Azerbaijan and America.

Elin Suleymanov
Consul general of Azerbaijan
Los Angeles

Debating Singapore

SIR – Singapore's minister mentor, Lee Kuan Yew, seemed to imply that Singaporeans are trading their freedom of expression for a stronger nation when he referred to the recent political upheavals in Thailand and the Philippines in a riposte to a suggestion (from a participant in a TV debate) that a little more such freedom might actually help the city state ("A rational choice", April 22nd). To think that Singapore would lose any of its hard-won economic development if its citizens enjoyed more freedom of expression is fallacious. Equally, the clamping down of free speech in the Philippines and Thailand does not help their quest to become new Asian tigers.

William Kwan
Hong Kong

Oil-price shock

SIR – I would like to reassure readers that all is not doom and gloom on the oil front ("Nostalgia for calmer days", April 22nd). I recently took my car to a petrol station and was pleasantly surprised to find that the price of premium-grade petrol had been reduced from 90 halala to 60 halala per litre. For those unfamiliar with Saudi Arabia's currency, this works out at 60 cents per American gallon.

John Christopher Williams
Dhahran, Saudi Arabia

Africa's rule of law

SIR – Barring your usual condescension towards Africa, it is not clear why the continent cannot be trusted to make the right choices on the terms of office for its leaders through constitutional change ("When enough is enough", April 8th). You seem to dislike these democratic processes simply because the outcome doesn't suit Western designs. For instance, the instability in the River Niger delta has nothing to do with President Olusegun Obasanjo's quest for a third term and everything to do with the selfishness of multinational oil firms. Similarly, it is extremely

disingenuous of you to blame Mr Obasanjo for the violence between Christians and Muslims, as this confrontation is almost as old as Nigeria itself.

Once upon a time, Africa was lambasted for not mimicking Western democracy, lock, stock and barrel. Now, having done so, it is blamed for making the wrong democratic choices. Maybe it is time for the continent to experiment with its own version of democracy, one which doesn't pander to greedy Western interests and is more attuned to its historical experience.

Emmanuel Ekiba Bagenda
Kampala, Uganda

Investment advice

SIR – Regarding whether public companies should or should not provide earnings guidance, there is a case to be made for smaller companies to provide guidance in some fashion ("The sound of silence", April 29th). If a firm's market capitalisation is not large enough to warrant coverage by security analysts, then it is almost incumbent upon the company to provide its own guidance. Without forward-looking information, investors have no way to judge the prospects for a firm and therefore will be less likely to consider it as an investment opportunity.

Donald Allen
Former director, National Investor Relations Institute
Vienna, Virginia

Precision drug

SIR – I have one minor quibble about your commendable article on medical marijuana ("Reefer madness", April 29th). You mentioned a nebuliser that "releases its cannabinoids without any of the smoke of a spliff, and with fewer carcinogens". A "spliff" normally refers to a cigarette mixture of tobacco and marijuana. Though not as hip, I believe the word you needed was "joint". Or as we call them here, "a big fatty".

Iain Duncan
Vancouver, Canada

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Japan and its neighbours

A giant stirs, a region bridles

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More and more Japanese want their country to have a normal foreign and defence policy. America agrees. China and South Korea aren't so sure

AP

AN ASCENDING economy, industrialising fast, that challenges the established power; hungry competition over energy resources; disputes over territory or spheres of influence; and nationalisms inflamed on one side by grievance and on the other by the opponent's presumption. It is becoming fashionable in policymaking circles to compare the situation of China and Japan today to that of Germany and Britain a century ago. Kent Calder of Johns Hopkins University, writing recently in *Foreign Affairs*, quoted Thucydides: fluid perceptions of power and fear are the classic causes of war.

The security perceptions in East Asia are fluid indeed, and so are the realities. China's attempts to modernise its armed forces have brought big increases in defence spending every year for several years, and the shopping-list is still growing: fighter aircraft, frigates, nuclear submarines and now aircraft-carriers. Some of the build-up has to do with China's desire to bring Taiwan back into the fold. But China also has ambitions for a blue-water navy, and seems to be probing at its biggest neighbour's defences as well. In November 2004 the Japanese found a Chinese submarine in their waters near the island of Okinawa. The Chinese claimed this was a mistake, and later apologised, but a dispute between China and Japan flared up last year over some oil-and-gas fields in the East China Sea, and Chinese spy planes have provocatively flown into the disputed airspace since then.

The lack of openness that accompanies China's military modernisation may reflect the backwardness more than the potency of the army: a Japanese general says that, were he in command of such decrepit equipment, he would not boast about it either. Still, the opaqueness merely adds to the neighbours' concerns about China's long-term intentions.

Profound changes are also under way in the armed forces of Japan and its ally, the United States. After the second world war, America imposed a pacifist constitution on the defeated Japanese. In return, it agreed to guarantee their defence, though they had to pay part of the bill. That is the way it still is. America has some 50,000 troops in Japan, a handful of air bases (including its biggest marine base abroad) and a port for the Seventh Fleet. Now, after nearly ten years of talks and much wrangling, the United States and Japan have at last reached an agreement on how to refresh this long-standing alliance.

It was clear that some changes were due. When the arrangements were put in place, the chief security risk in the region was thought to be an invasion of Japan by the Soviet Union. In 1996, with both risk and country gone, Bill Clinton and Ryutaro Hashimoto, then America's president and Japan's prime minister respectively, said it was time for a review. Nothing has become easier since then. China has continued to rise. The possibility of a war over Taiwan, whose security America also guarantees, remains. Recalcitrant North Korea has developed both nuclear weapons and new missiles to carry them. And, since September 11th 2001, everyone is on the lookout for terrorism.

The new agreement completes the most sweeping reorganisation of American forces in the Pacific since the Vietnam war. By 2014 some 8,000 marines and their families will leave crowded Okinawa, home to half of all American servicemen in Japan, for the Pacific island of Guam, an American dependency. From Guam, the marines are supposed to be able to respond with lightning speed to an array of regional emergencies. Whatever benefits the Americans have brought to Okinawa—in terms of cash, employment and security—they have also earned some hostility, especially when one of their number has raped or murdered a local girl. The marines' Futenma air base, the most unpopular of all the bases in Okinawa, will now be closed, and the land returned to farmers who have grown rich off the Americans' rent and will now grow richer still by selling their acres for development: the base is jammed next to the town of Ginowan. A new floating heliport, controversial but less so than Futenma, is to be built for the marines over a coral reef off Okinawa's less populated eastern coast.

In addition, an American naval air wing now based at Atsugi, just outside Tokyo, will move to Iwakuni, 725 kilometres (450 miles) to the south-west, near Hiroshima; a dozen refuelling aircraft from Futenma will also go to Iwakuni. Other servicemen are also expected to move to Guam, or even Hawaii.

Japan's politicians will be pleased to have reduced a long-standing irritant. For their part, the Americans believe they will be able to react faster to a wider range of possible emergencies—a crisis involving North Korea, say, or Taiwan, or an act of terrorism that might perhaps threaten the crucial shipping lanes of South-East Asia, or indeed anything at all that might happen in the “arc of instability” that Pentagon planners see stretching from North Korea to the Middle East.

And that is not all. While America keeps Japan as its main base in Asia, Japan will play a much greater part in its own defence. Politicians in Washington, DC, complain that Japan gets American protection on the cheap, spending just 0.9% of GDP on defence, or $45 billion a year, barely a tenth of America's military budget. The total cost of the new “realignment” has not been made public, but Japan has agreed to pay three-fifths of the $10 billion that moving the marines alone will cost. In the long run, says America's chief negotiator, Richard Lawless, Japan will have to fork out at least $26 billion. And the Japanese will have to carry out, and pay for, some of the work that the United States has been doing on their behalf in the past.

Prometheus loosens his bonds

In fact, America's military transformation in Asia could mean an equally profound transformation of the Japanese armed forces. The change is already under way. During the cold war, Japan's own “ground self-defence forces” (pacifist Japan's term for its army) laid stress on tank and infantry divisions, with the aim of repelling a Soviet invasion. Since then, Japan's ground forces have shrunk in importance, whereas its navy has grown into a force of considerable reach and sophistication. Japan has recently launched its own spy satellites. A sweeping reorganisation of the self-defence forces last month put the navy, army and air force under a single command for the first time since the second world war.

Japan and America increasingly emphasise the sharing of technology. They are also trying to improve their joint command structure—an essential part of the two countries' new agreement—and they have recently started to test anti-missile systems. Japan's enthusiasm for missile defence leapt in 1998, when North Korea test-fired a Taepodong rocket that crossed the main island of Honshu. North Korea, though, is not the only worry. Japanese defence planners admit in private that missile defence is also being developed with China in mind. After all, the 800 missiles that China has ranged against Taiwan could also reach Japan—and, as a senior American official admits, the defence of Taiwan could not be accomplished without using bases in Japan. To accusations from China of meddling in “internal” Chinese affairs, Japan now says it considers Taiwan to be a security concern shared in common with America.

Expectations are now growing both inside Japan and beyond for the world's second-biggest economy to perform a more muscular role in international security operations. Yet Japan's military modernisation is rubbing up against the limits of the constitution. These have already been stretched, notably by Junichiro Koizumi, prime minister since 2001. After the attacks on the Twin Towers, Mr Koizumi threw Japan's loyalties firmly behind George Bush's “war on terror”. In late 2001 he won parliamentary backing to send two naval refuelling tankers to the Indian Ocean to help the United States and its NATO allies topple the Taliban in Afghanistan. Though a new law

had to be written, and the ships were limited to giving logistical support, this was, by post-war Japan's standards, an unprecedented projection of its military capabilities.

Later, Mr Koizumi pushed for Japanese peacekeeping troops to be sent to southern Iraq. The 600 troops there are still embarrassingly constrained in their actions—they are, in effect, protected by Australian peacekeepers nearby—but their presence nevertheless marks another bold move by Mr Koizumi. They show that Japan's leaders now see that the national interest may sometimes lie far from home—and that the constitutional taboo on sending Japanese troops abroad can in fact be broken.

The prime minister has proved an acute judge of a changing national mood. What is sometimes called the “normalisation” of Japan is increasingly popular. In a poll for the *Yomiuri Shimbun* last month, for instance, over half of those asked said they favoured changing the constitution in order to allow Japan to play a greater international part. Other polls suggest that most people support Japanese troops' active involvement in peacekeeping.

A hint of extroversion

The new mood is reflected in the shifts taking place in politics. The landslide of Mr Koizumi's Liberal Democratic Party (LDP) in last September's general election buried what remained of the pacifist left in Japanese politics. A majority of LDP members of parliament favour changes to the constitution. An amendment drafted by the party last autumn proposes to remove the ambiguities surrounding the role of the armed forces and to underline Japan's right to take part in international operations outside the country's borders. The main opposition group, the Democratic Party of Japan, is also increasingly robust about foreign policy. Its new leader, Ichiro Ozawa, elected last month, has long argued for a more assertive Japan. So constitutional debate, including the possibility of rewriting the pacifist Article 9, is now on the political agenda, even if it is likely to be years before any constitutional change is agreed on.

Whereas Americans, in particular, think that Japan is taking only baby steps towards assuming a greater international role, and are impatient for more, two of its closest neighbours view the prospects of a more activist Japan with rising alarm. Policymakers in China and South Korea claim to detect in Japan's push for “normalisation” the dangerous rearming of an historical foe and colonial overlord.

Much of this is overblown. Even the hawkish LDP's latest constitutional draft reasserts Japan's renunciation of war as a sovereign right. And the notion that Japan still harbours territorial designs on either the Korean peninsula or the Chinese mainland (or even Taiwan) is potty. Unfortunately, Japan does itself no favours when it comes to reassuring the neighbours.

Picking at the scabs of history

The problem is that the normalisation of Japan's defence is not being matched by what could be called the normalisation of its nationalism, and the prime minister shares a part of the blame. In his five years in office, Mr Koizumi has five times visited Tokyo's Yasukuni shrine, where the 2.5m servicemen who have fallen in wars since 1868 are honoured, but where the names of 14 Class A war criminals from the second world war are also memorialised. Mr Koizumi claims to visit the shrine as an individual, not an office-holder, and does so, he says, in order to honour the innocent dead. He usually accompanies his visits with a condemnation of Japan's past belligerency. Still, the visits feed into deeply held feelings in China and South Korea that, despite dozens of official apologies, Japan has yet to atone fully and sincerely for its wartime past. The point is also

emphasised by school textbooks that gloss over Japan's wartime atrocities, and by continued Japanese reluctance to compensate the victims of Japanese militarism.

Yet the shriller China and South Korea become—venomous anti-Japanese riots broke out in China last year—the more inclined are ordinary Japanese to thumb their nose at the complaints. In that sense, Mr Koizumi merely exemplifies an attitude that seems to find honour in Japan's isolation. And this provides cover for the Japan-as-historical-victim school that exists not just on the far right of Japan's politics, but also as a central if small part of the LDP.

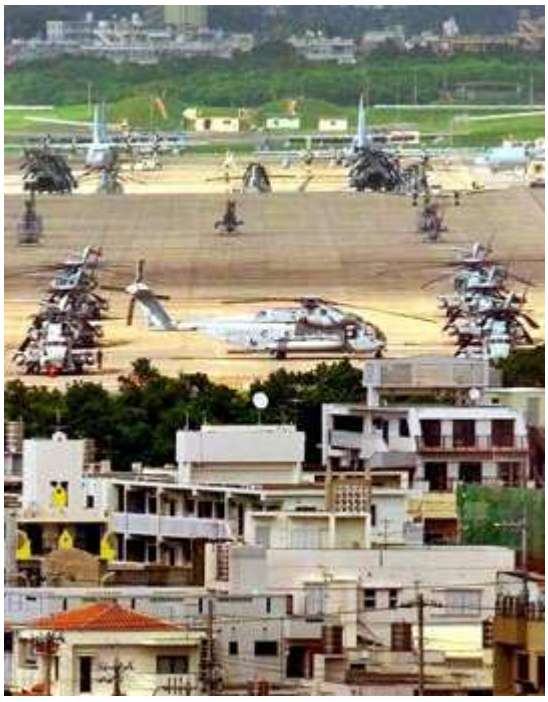
Even so, Japan pays a price for being on bad terms with its neighbours. No summit meetings have been held with China since 2001. If Mr Koizumi meets Chinese leaders at all, he meets them briefly on the fringes of multilateral gatherings. President Roh Moo-hyun of South Korea has also suspended meetings with Mr Koizumi. Diplomats say that Japan's bilateral relations with China and South Korea have been damaged at every level, and former channels of communication closed. A consequence is that Japan is unable to take any regional initiative (over the environment, for instance, or energy use) at the very time it is seeking international “normalisation”.

The scratching of historical scabs has also inflamed the many island and seabed disputes in the seas dividing Japan from China and South Korea. China has long challenged Japan's control of the Senkaku islands, a rocky outcrop known as the Diaoyutai in Chinese. More recently, China and Japan have squabbled about some oil and gas deposits below the East China Sea. China has now annoyed Japan by starting to extract some of the gas.

A simmering dispute between South Korea and Japan over two islets, the Dokdo, which Korea controls but which Japan claims and calls Takeshima, has suddenly boiled over. Japan's coastguard said last month that it was sending two unarmed vessels to map the seabed around the blasted rocks, a couple of months before an international hydrographic conference at which South Korea was expected to offer Korean names for some submerged features. Furious, South Korea dispatched armed patrol boats to the area. Diplomats scrabbled to avert a confrontation, and achieved a deal whereby Japan would withdraw its surveyors if South Korea withdrew its list of names.

The matter is unlikely to stay shelved. President Roh went on television a few days after the deal in belligerent mood to say that “Japan's present claim to Dokdo is an act of negating the complete liberation and independence of Korea...no compromise or surrender is possible, whatever the costs and sacrifices may be.” Mr Koizumi's offer of a summit was rebuffed.

AP



The incident is a reminder of how suddenly Japan's relations with its neighbours can get out of hand. Plainly, repairs are needed, and plenty of suggestions have been forthcoming. They include joint history projects that might attempt to reach a consensus of sorts about the past; more regional forums; and a national debate in Japan about how to honour the dead and guard a sense of national identity without inflaming neighbours. Some of the more sensible ideas come from Japan's soldiers. One suggests building trust with China by setting up joint search-and-rescue missions and procedures for accidental collisions in an ever-busier sea.

Infantile paralysis

Goodbye sonic bang, hallo property boom

China will certainly need to play its part. The leadership of China's Communist Party has for so long used anti-Japanese sentiment to bolster its own legitimacy that once-warm feelings in Japan towards the Chinese have cooled, particularly since the anti-Japanese demonstrations last spring, when 24m Chinese, it was claimed, signed an internet petition opposing Japan's bid for a permanent seat on the UN Security Council. Such stridency constrains any Japanese leader judged at home to be appeasing China.

Japanese politicians can be blamed for doing too little to assuage fears by making their case, which is a reasonable one, clearly and unthreateningly. Yet Hu Jintao, the Chinese president, has also made a poor fist of relations with Japan. Though he has written off all hope of improving ties with Mr Koizumi, he is under pressure at home to make a fresh start with Japan after the prime minister goes in September. One Beijing academic likens the two countries in the East China Sea disputes to “children climbing on the table to fight over a glass of milk”.

Japan's role in the region suddenly seems to be a factor in the LDP race to succeed Mr Koizumi (see article). Candidates are under pressure to show the neighbours a measure of good faith, starting by staying away from Yasukuni. Both Japan and China appeared this week to be groping towards better relations. They said their talks over the East China Sea gas fields would restart next week, and their foreign ministers will meet again before long, too.

At some point, mutual suspicions over Taiwan will also have to be dealt with, and on this some Japanese see hope. They argue that Mr Hu's recent rather subtle approach towards the island—courting the opposition Kuomintang, isolating President Chen Shui-bian and his crumbling independence movement, and counting on greater economic integration between Taiwan and the mainland to achieve more than bluster and military threats—could do much to reassure Japan about China's intentions. So there is a chance that Japan and its neighbours could start to put their problems behind them. But that's what it is—a chance, no more than that for now.

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George Bush

In Carterland

May 11th 2006 | WASHINGTON, DC
From The Economist print edition

A presidency that is shrinking even as you look at it

Reuters

Get article background

A FORTNIGHT ago, George Bush entertained the annual White House Correspondents' Association dinner with a double act with a look-alike. Mr Bush flattered the audience with the usual bromides ("As you know, I always look forward to these dinners") while his doppelganger voiced his real feelings ("It's just a bunch of media types, Hollywood liberals, Democrats like Joe Biden. How come I can't have dinner with the 36% of the people who like me?") The good news for Mr Bush is that the double-act went down a dream. The bad news is that, according to two of the latest opinion polls, the proportion of people who like him is now 31%.

Mr Bush's poll numbers are collapsing at a rate that has political junkies searching for comparisons. Only four post-war presidents—Harry Truman, Jimmy Carter, Richard Nixon and Mr Bush's father—have hit lower approval ratings (at some point) than Mr Bush. No president in the history of polling has ever gone into mid-term elections with such dismal numbers.

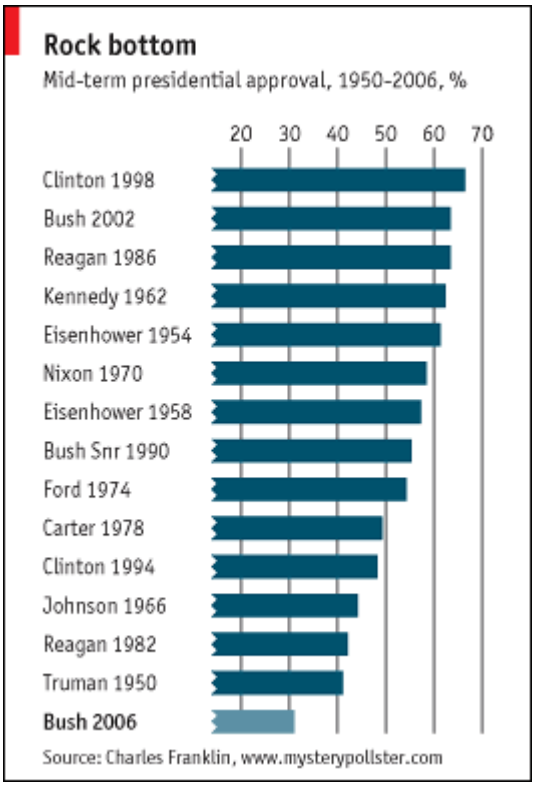
Mr Bush is flailing even on issues that were once his strong point. The *New York Times*/CBS News poll shows that the number of people who think that he was right to invade Iraq has fallen from 47% in January to 39% today, and more people think the Democrats share their moral values (50%) than the Republicans (37%). The polls also reveal a much more serious problem.

The president's political strategy has always rested on supercharging the base while attracting just

enough independents and Democrats to give him a majority. But the Democrats have long since abandoned him (that approval rating stands at 4%), and now it looks as if the base has had enough. The *New York Times*/CBS News Poll and the *USA Today*/Gallup polls both found that only about 50% of conservatives approve of Mr Bush's performance. The figure for Republicans hovers in the high sixties. Their list of complaints is long. Small-government conservatives hate his lax spending. Paleo-conservatives hate his immigration policies. Libertarians hate his meddling in medical-ethics cases. John Zogby, a pollster, says that Mr Bush's job approval has fallen to 50% or less among gun-owners and even evangelicals.

Mr Bush's dismal poll numbers are limiting his ability to manage Congress. Normally loyal Republicans such as the House speaker, Dennis Hastert, are criticising his pick for the directorship of the CIA (see article). The Senate ignored his veto threat and approved an inflated $109 billion spending bill. The House is in open revolt against his immigration-reform plans.

Add Congress's own problems and you have the making of a Republican meltdown. The Jack Abramoff corruption scandal, the guilty plea of Randy “Duke” Cunningham on bribery charges, various unfolding FBI investigations, the latest bloated spending bills, all give an impression of a party that is more interested in enjoying the fruits of power than representing conservative principles.



An aura of dread now surrounds the mid-term elections. Why should conservative activists turn out to support a president who is spending money like a liberal? And why should they turn out to re-elect a Republican Congress that can't get its act together on anything that matters? Mike Murphy, a Republican operative, says that if the election were held today, “the odds are 90% that we'd lose the House”. Some analysts talk of a Democratic tidal wave.

The White House is fighting back manfully. Mr Bush is in campaign mode, criss-crossing the country and raising lots of money. Josh Bolten, the new chief of staff, has re-energised the White House. Karl Rove is focusing on what he does best—preparing for the mid-terms. Mr Rove has told conservative activists that the administration is preparing to send the names of more than 20 judicial candidates to Capitol Hill—a sure way of exciting the base.

But there is an air of desperation about much of this. Republican strategists are relying mainly on fear to motivate the troops. Mr Rove raises the spectre of the Democrats taking over Congress—and then using their newfound power to humiliate the administration with endless investigations. Conservative political analysts console themselves with the thought that the Republicans have certain structural advantages—such as gerrymandering and incumbency—that could protect them from public disillusionment. But if this is all you can say in your defence, then you are running on empty.

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The CIA's new boss

The general and the Gosslings

May 11th 2006 | WASHINGTON, DC
From The Economist print edition

Michael Hayden wants to shake up the CIA. Good luck to him

Reuters

Pity about the uniform

“DESPITE what you've seen on television, our agency doesn't do alien autopsies, track the location of your automobile by satellite, nor do we have a squad of assassins.” That, notes James Risen in his book “State of War: The Secret History of the CIA and the Bush administration”, was how Michael Hayden sounded before September 11th 2001. He was then the head of the National Security Agency (NSA) and, as the quote from a speech in 2000 shows, his prime concern was to reassure Americans that their intelligence services were not to be feared.

These days Americans are harder to reassure. They will expect General Hayden, who was named this week as the new boss of the CIA, to keep them safe. And they worry that agencies such as the CIA are not, in fact, much good at this. Spooks failed to predict September 11th, the absence of unconventional weapons in Iraq, or the severity of the insurgency there. Before that, they failed to spot that the Soviet Union was about to collapse.

America's military technology is such that if a terrorist can be located, anywhere, he can be blown to pieces. But its ability to gather “human intelligence” is rather limited. During the cold war, American spies working under cover as diplomats “could approach potential contacts at receptions”, notes the latest Congressional Research Service intelligence brief. “Today, however, the need is to seek information from clandestine terrorist groups who do not appear at embassy social gatherings.”

The CIA also faces accusations of political partiality from the right. In the past four years, leaks undermining President George Bush's Iraq policy “represent a new and corrosive level of institutional disloyalty”, reckons the *Wall Street Journal*. Republican fury at the agency is unlikely to be soothed by the news this week that Valerie Plame Wilson—an agent whose name was leaked during a bitter debate about whether Mr Bush lied about the pre-Iraq-war intelligence, leading to an investigation and the vice-president's chief of staff's indictment for perjury—has sold her memoirs for a tidy $2.5m.

The man General Hayden replaces, Porter Goss, was put in charge of the CIA 19 months ago to make it more effective and less hostile to the administration. The abruptness of his departure suggests that he failed. Insiders complain that he pushed out too many experienced agents, and brought in too many “Gossling” cronies. He reportedly skirmished often with the Directorate of National Intelligence (DNI), a new umbrella organisation that oversees the CIA and 14 other intelligence agencies. There is a hint of scandal, too; one of his protégés, Lyle “Dusty” Foggo, is being investigated for his friendship with a military contractor accused of supplying prostitutes to a

congressman recently jailed for accepting bribes.

Whether General Hayden can clear up this mess remains to be seen. He has 20 years' experience of intelligence work. His relationship with the DNI is likely to be better than Mr Goss's; he is currently the number two there. Some think his uniform disqualifies him for the post. But Dianne Feinstein, a Democrat on the Senate Intelligence Committee, said General Hayden could solve that problem by retiring from the air force. She added that under him, the “Gosslings will go”.

For civil libertarians, the main worry about General Hayden is his role in Mr Bush's programme of warrantless wiretaps in America. As head of the NSA, he implemented it. When its existence was revealed by the *New York Times*, he defended it as both necessary and legal.

Many disagree. His appointment is “the latest example of President Bush giving promotions to those who have led the greatest attacks on our constitution and fundamental freedoms,” said Anthony Romero, head of the American Civil Liberties Union. Some Democrats think Mr Bush is trying to provoke a fight over the issue. Such a scrap would doubtless do Republicans no harm, as voters probably care less about suspected terrorists' privacy than they do about not being killed.

That said, ordinary Americans find it impossible to assess whether they get good value for the billions they spend on intelligence. How many jihadist plots has the CIA foiled? No one knows. How close is Iran to building a nuclear bomb? What would it do with one if it had it? Who is really in charge in Tehran, anyway? No one has any idea how accurately America's spies can answer these questions.

General Hayden claims that counter-terrorist efforts are going quite well. Last month, he said they had “seriously damaged” al-Qaeda and disrupted its operations. Osama bin Laden and his cohorts now have to “devote inordinate effort and time to their own security”, he said. As others note, they have to use runners instead of satellite phones and the informal *hawala* system instead of banks. They find it much harder to plan and co-ordinate attacks—hence their failure to stage another on American soil since September 2001.

But, he conceded, the terrorists' tactics have evolved. There is a growing danger from those “inspired by, but not actually connected to, al-Qaeda”. Jihadists, “although a small percentage of the global Muslim population, are increasing in both their number and in their geographic dispersion,” he said.

General Hayden did a decent job of reforming the NSA, reckons James Lewis of the Centre for Strategic and International Studies, and has “a good shot” at doing the same in Langley. His probable civilian deputy, Stephen Kappes, a “highly respected clandestine officer”, will be his “passport into the tribe, interpreter and guide”, says Mr Lewis.

It is still a daunting task. Intelligence agencies have to be secretive, but their secrecy makes them harder to hold to account. And their culture is nearly as bureaucratic as the rest of government. In a recent survey, only 29% of intelligence officials said that their incompetent colleagues had been weeded out.

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The Mississippi Delta

Renaissance deferred

May 11th 2006 | CLARKSDALE, MISSISSIPPI, AND HELENA, ARKANSAS
From The Economist print edition

One of America's poorest corners tries to pull itself up

ALONG the back roads that lead from eastern Arkansas to the Mississippi river, the fields stretch flat and bleak on either side. Behind the wooden shanties that still stand, faded relics of the 1940s, long rows of dry unplanted dirt stretch to the horizon. Of the 9.4m people who live in this region, 1.7m are considered to be in poverty. Helena, Arkansas, was once a wealthy port city with ante-bellum and Victorian houses on the Mississippi bluffs. However, as the town sinks further into poverty and racial strife, those once handsome buildings are crumbling.

Helena's shabby signs of past prosperity offer one of the rare clues that in the mid-19th century this was one of the richest regions of the United States. The Delta, originally under swampy forests, had been opened up by logging companies, who laid the first railway tracks in the early 1800s. Towns and farmers followed. By 1860, a quarter of America's millionaires lived in Natchez, Mississippi. Then came the civil war. The Delta was devastated, its bridges and railways smashed. In 1927, the Mississippi broke out of its levees in 145 places and flooded 27,000 square miles.

As cotton farming was increasingly mechanised (and as King Cotton lost its dominance, after peaking in 1930), many blacks fled north. By the 1990s, most of the successful farms were feudal

businesses controlled by wealthy white landowners who owned the hamlets in which their black workers lived. But in recent years many farmers have declared bankruptcy, forcing ever more rural blacks to depend on welfare. Pete Johnson, the co-chair of the Delta Regional Authority (DRA), describes the country-dwellers as “unmotivated, uneducated and unhealthy”.

The statistics bear this out. According to the Southern Growth Policies Board, a think-tank based in North Carolina, the drop-out rate in 2001 among high-school students in the Delta was 5.5%, compared with 4.4% nationally. The March of Dimes, a children's charity, reported in 2002 that infant mortality was nearly 10%, compared with 7% nationally. In 2003, income per head was $20,484; the national average was $31,472.

The Delta's future depends on the DRA, a federal-state partnership created by Congress in 2000, and the latest permutation of the task-forces and organisations that, over the decades, have struggled to improve things. The DRA's funds—a mere $12m drop in the 2006 federal budget—are aimed at helping 240 counties in eight states, 133 of them in Arkansas, Louisiana and Mississippi.

The agency is mostly staffed by people who live in the region and are eager to see change. Its express purpose is to co-ordinate projects with the relevant states and to cut through red tape. It is creating, or helping to retain, 36,000 jobs, mostly in manufacturing, which will generate $1 billion in salaries; it has also helped 23,000 families to get running water and sewerage. The Government Accountability Office recently reported that, out of ten agencies and three regional commissions, the DRA comes top in the percentage of funds spent in rural America.

Delta residents also help themselves. Morgan Freeman, an actor who was born locally, has poured millions into Clarksdale, the Mississippi town where the DRA is based—near the crossroads where the great blues-singer, Robert Johnson, is said to have sold his soul to the devil in exchange for magical guitar-playing skills. Together with a local lawyer, Mr Freeman has opened a blues club, “Ground Zero”, and an expensive restaurant.

Investors have sometimes supposed that cities near the region—St Louis, Missouri, Birmingham, Alabama, and New Orleans—could act as economic hubs. But luck is against the Delta. For years, it benefited from New Orleans's tourism, ports and jobs. Tourists who visited New Orleans often travelled up Highway 61 to Memphis, the Delta's only large city, searching for Elvis and Beale Street, the home of the blues. Then came Hurricane Katrina, and all this changed. Some of the Delta's towns, already struggling with their flimsy infrastructure, have doubled their populations since the hurricane. The only silver lining is that the DRA's money for this fiscal year has also been doubled.

Plans, or hopes, for survival

To be a viable economic region, the Delta must succeed in three areas: transport, technology and health care. The construction of Interstate 69 (the “NAFTA super-highway corridor”), winding from Canada to Mexico through the Delta, is crucial. The road depends on a new bridge to link Arkansas and Mississippi; it has been designed, but it will cost $715m and no federal money has been appropriated. The Federal Highway Administration admits that the highway is still at the “concept project” stage. It may never be completed.

Technology is the next challenge. The conundrum is that although the Delta's residents cannot compete in business, education, government and health care without the internet, a high percentage of zip-codes in the region have no internet access. People living in areas that do have access show a high level of entrepreneurial skill. So, even though its efforts will be limited to the relatively few households that are wired, the DRA is hoping to join the private sector in encouraging the exchange of goods and services online.

The workforce may be willing but it is often unhealthy. Stroke, heart disease, diabetes, asthma and obesity plague residents. Most of them have no health insurance, says the University of Arkansas for Medical Sciences. And the great majority of the Delta's counties or parishes are classified as “medically underserved” by the federal government.

The region's chief crops remain cotton, soyabeans and rice (see article), all heavily subsidised. But the future could lie in different crops altogether: sweet potatoes and switchgrass. Last month, Helena announced that it would open a $2m sweet-potato storage and distribution plant which would supply Gerber's, a firm that makes baby food. East Arkansas farmers once led the country in sweet-potato production (their soil was perfect for the crop). But the industry moved to North Carolina, where the storage sheds were climate-controlled. As for switchgrass, the Delta could become the first bio-refinery in the United States to use that grass, plus wood-chips, to make fuel. If this happens, the region would have discovered a sustainable 21st-century industry.

Mr Johnson of the DRA is an optimist who believes that the whole area can rise again. “The nation's most resilient people live in the Delta,” he says. His words are a triumph of hope over 140 years of numbing and bumbling experience.

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Delta irrigation

To save a woodpecker

May 11th 2006 | CLARENDON, ARKANSAS
From The Economist print edition

Can a bird stop the pumps coming?

THE ivory-billed woodpecker is not large, as birds go. It is about the size of a crow, but flashier. Its claim to fame is that, though it had been thought extinct since 1944, a lone kayaker spotted it about two years ago, flying around among the cypress trees in the Cache River National Wildlife Refuge. And that sighting may prove the death-blow to a $319m irrigation project in the Arkansas corner of the Delta.

The Grand Prairie Area Demonstration Project seemed, at first, a fine idea. The Grand Prairie is the fourth-largest rice-bowl in the world, with 363,000 acres under paddies. But it is running out of water, with farmers driving wells deeper and deeper into the underlying aquifer. The new project, dreamed up around a decade ago, would tap excess water from the White river when it floods and pump it, at the rate of about one billion gallons a day, to storage tanks on around 1,000 rice farms.

AP

The rice farmers' foe

Unfortunately, it would also divert water from the region's huge, swampy wildlife refuges, home to black bears and alligators and the pallid sturgeon. Tiny swamp towns like Clarendon and Brinkley, which are heavily black and almost destitute, rely on nature tourism for the little economic activity they have. In Brinkley, the barber offers an “ivorybill” haircut that makes you look like one.

The project has some powerful local backers. They include Blanche Lincoln, the state's senior senator, who grew up on a rice farm in Helena, and Dale Bumpers, a former four-term senator and governor of Arkansas. Mr Bumpers, long an icon of the environmental movement and prominent in the efforts to establish the refuges, now believes the water project is important for national security in food and trade, and that it will not damage the forests he has worked to protect.

Opponents worry that the project, apart from its environmental risks, will overwhelm the innovative water conservation methods that rice-farmers are already using, and give the biggest water users an unfair advantage. They also object that it means using subsidised pumps to provide subsidised water for a crop that doesn't pay. Rice is one of the most heavily assisted crops in America; rice payments cost taxpayers almost $10 billion between 1995 and 2004, and rich farmers round Stuttgart in Arkansas County (an efficient and politically shrewd group) took in $21.2m in subsidies in 2004 alone.

The Bush administration has so far resisted funding the project, although Congress awarded it

$12m in 2002 and the state of Arkansas has put up enough to get construction under way. It was only 20 miles from the building site that the woodpecker was seen and its distinctive “double rap” heard. The lawyers are now busy.

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Human rights

Straightening the record

May 11th 2006
From The Economist print edition

Some welcome signs of a change of tone from the Bush administration

COULD it be that the penny has finally dropped? Ever since the terrorist attacks on September 11th 2001, dismay has grown around the world at the Bush administration's apparent willingness to ignore both domestic and international laws in pursuit of its war on terror. “We will take the gloves off!” Donald Rumsfeld, the defence secretary, famously declared. In retrospect, that seemed like a euphemism for what was to follow: Guantánamo, Abu Ghraib, the torture memos, indefinite detention without trial, extraordinary rendition, warrantless eavesdropping, secret CIA prisons, “ghost” detainees.

AP

Handling them a bit more carefully

Could this really be the America of human rights and the rule of law? Patrick Leahy, a Democratic senator from Vermont, has called Guantánamo Bay “the primary recruiting tool for our enemies...a national disgrace”. Lord Goldsmith, Britain's attorney-general, described it on May 10th as “unacceptable”, tarnishing America's traditions. Even Tony Blair, Britain's prime minister and one of America's staunchest allies in its war on terror, has at last agreed that “it would be better if it was closed”.

For a long time, the administration responded to such criticism with a defiant “we-can-do-what-we-like” attitude. America had suffered the worst-ever foreign-inflicted atrocity on its soil. Nearly 3,000 civilians had been killed. The armed conflict against al-Qaeda was a new kind of war that required new rules. The Guantánamo detainees were brutal killers, “evil men”. America had a right to protect itself. All true, but was it worth the cost of losing allies and making even more enemies?

For the past year or so, the tone coming out of Washington, DC, has been getting noticeably

softer. The most flagrant abuses appear to have stopped. The rules have been tightened. The worst culprits are being called to account, and the detainees are (slowly) getting access to the courts. Now President George Bush has said that he would “very much like to end Guantánamo”. Although that is unlikely to happen soon, this marks a new approach.

A similar change of attitude was evident at hearings in Geneva this week on America's compliance with the UN Convention Against Torture. In America's first appearance since 1999 before the Committee Against Torture, the UN watchdog on the treaty, a delegation of 25 officials led by John Bellinger, the State Department's chief legal adviser, fielded tough questions on the treatment of detainees with unusual candour and even deference.

Although he admitted that “shocking” errors had been committed in the past, Mr Bellinger claimed that these were relatively isolated incidents and that America's record had now “without question, improved”. He insisted on America's “absolute commitment to upholding our national and international obligations to eradicate torture and prevent cruel, inhuman or degrading treatment or punishment anywhere”, even in times of war. Asked about “waterboarding”, a near-drowning technique allegedly used against at least one detainee, he said it had never been allowed and would be banned in the revised Army Field Manual.

Of the hundreds of thousands of American servicemen and women who had been deployed in Afghanistan and Iraq, around 800 had been the subject of investigations for the alleged mistreatment of prisoners, he said. Although in many cases no misconduct had been found, action had been taken against more than 250. Of these, 89 had been convicted by courts-martial, and 19 sentenced to at least one year's imprisonment. More than 100 others had received non-judicial punishments; 28 had been cashiered. About 170 investigations remained open. Contrary to the claims of some human-rights groups, he insisted that soldiers were indeed being held to account.

Earlier, at a stop-over in Brussels en route to Geneva, Mr Bellinger answered journalists' questions about the so-called CIA “torture” flights that have allegedly transported kidnapped terrorist suspects to third countries for harsh interrogation. Some accusations had become “so hyperbolic as to be absurd”, he said. Only “an extremely small number” out of hundreds of CIA flights over Europe since the September 11th attacks had carried suspects, and not one had been “for the purposes of interrogation using torture”. The last alleged case of “rendition” occurred nearly three years ago.

On the International Criminal Court, too, the administration has subtly changed its tune. No longer is the world's first permanent war-crimes tribunal reviled, in Tom DeLay's phrase, as “Kofi Annan's kangaroo court”, to which America would remain forever opposed. Officials now talk of the need to “work constructively” with it, particularly over Darfur, and “to move beyond divisiveness on this issue”. Some have even begun to agree in private that “there is a role for all types of tribunal, including the ICC”.

It will take a while for people to accept again Mr Bush's assertion this week that “America is strong on human rights.” But at least public relations are improving.

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Mary Cheney's memoirs

Alternative flack

May 11th 2006 | WASHINGTON, DC
From The Economist print edition

Gay, proud and Republican

eyevine

POLITICS is a dirty game. During the campaign of 2004, Mary Cheney, the vice-president's daughter and aide, was planning a rally for her dad on Ellis Island, to highlight his faith in the American Dream. But then she heard that John Kerry had had the same idea. A colleague suggested feeding French fries to the seagulls. When Mr Kerry's advance team arrived, they were greeted by “hundreds of big, aggressive noisy, defecating” birds. They went elsewhere.

One would expect Dick Cheney's offspring to be tough, smart and partisan. His daughter's new memoir, “Now It's My Turn”, shows she is all three. Goading seagulls to crap on your opponents is fine. But when both Mr Kerry and his running mate, John Edwards, mentioned Ms Cheney's lesbianism during debates, that “took sleazy politics to a whole new level”. Mr Edwards is “complete and total slime”. Mr Kerry is “a complete and total sleazeball”.

To be fair, Ms Cheney has endured more flak than the average flack. As a prominent gay Republican, she has been called a “Nazi sell-out”. Small wonder she's touchy. Her loyalties are torn, too. She says she nearly quit the campaign when it became clear that Mr Bush would back a constitutional amendment barring gay marriage. Such a law, she says, would be “a gross affront to gays and lesbians everywhere”. Her father opposed it.

Ms Cheney was irked, in 2004, that gay-rights groups deemed her sexuality fair game for public comment. Today, these same groups applaud her denunciations of the Federal Marriage Amendment, which will come before the Senate again next month. It will not pass, but it will help keep Ms Cheney's party a minority preference among America's gays.

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Lexington

In defence of John McCain

May 11th 2006
From The Economist print edition

A front-runner's gotta do what a front-runner's gotta do

SIX years ago, John McCain denounced Jerry Falwell as an “agent of intolerance” who belonged to the “outer reaches of American politics”. This Saturday Mr McCain is travelling to those very outer reaches—to Mr Falwell's Liberty University in Lynchburg, Virginia, no less—to give the commencement address. The city website notes that Lynchburg is famous for products such as ChapStick and the “first disposable douche”; but from now on, as far as many liberals are concerned, it will be famous for Mr McCain's capitulation to the forces of darkness.

Their outrage is hardly surprising. Mr Falwell is a hate figure on the left—one of the leaders of the now defunct Moral Majority and a man much given to fulminating against homosexuals (“brute beasts”), feminism (“a satanic attack on the home”) and all those whose search for an alternative lifestyle “helped” September 11th to happen. Liberty University is a “Bible boot camp”, in Mr Falwell's words, that forbids its students to drink, smoke, dance or watch “R”-rated films and specialises in producing “champions for Christ”. Mr Falwell exhorts his students to burn the university down if it ever turns liberal. No wonder Jon Stewart, a particularly sharp comedian, asked Mr McCain whether he's “freaking out on us”.

Moreover, Mr McCain's dalliance with Mr Falwell is not the only example of his lurch to the right. Recent pronouncements from Arizona's senior senator include backing teaching “intelligent design” in schools (on the ground that people need to understand both sides of the argument), supporting South Dakota's draconian anti-abortion law and endorsing Arizona's constitutional amendment to

ban same-sex marriage. He now supports extending tax cuts that he once opposed. And he never misses an opportunity to doff his hat to his former nemesis, George Bush—calling him “one of the great presidents of the United States” and defending him on everything from the Dubai ports deal to his new choice for director of the CIA.

But before McCain 2008 is accused of betraying the great principles of McCain 2000, it is vital to remember three things. The first is that McCain 2000 lost. Liberals may have thrilled as Mr McCain told the religious right where to go, but this was hardly sensible politics in a party in which evangelical Christians make up half the primary electorate. The second is that McCain 2000 was as much a product of political calculation as McCain 2008. In 2000 Mr McCain was running against an establishment insider in the form of Mr Bush. So he ran an insurgent's campaign—turning the press into an echo-chamber and mobilising independents and youngish Republicans. This time around he is the front-runner. So he is pursuing Mr Bush's strategy—often with the help of Mr Bush's former functionaries—of locking up campaign contributions and rounding up big-name supporters such as Trent Lott and Haley Barbour.

The third thing to remember is that Mr McCain is not changing quite as much as people think. He was never the liberal that many, especially the press, imagined. Far from it; he is a conservative Republican (he holds Barry Goldwater's old Senate seat and has a bust of him in his office) who believes in small government, a strong defence and traditional values. He is a foreign-policy hawk who has repeatedly criticised Mr Bush for failing to send enough troops to Iraq (in 2000 the neocons at the *Weekly Standard* were much keener on Mr McCain than on Mr Bush). He is a budget hawk who has done more than any other senator to crusade against “earmarks”, pork-barrel spending and the lobbying industry, and who voted against Mr Bush's bloated highway bill and his irresponsible prescription-drugs benefit. One of his main complaints against Pat Robertson and Mr Falwell in his “agents of intolerance” speech was that they questioned his pro-life credentials.

A new sort of Republican

Mr McCain also remains a lone wolf who is willing to defy the conservative establishment on everything from global warming (which he worries about) to stem-cell research (which he supports). At the end of last year he delivered a public snub to Mr Bush by piloting an anti-torture bill through Congress. He is currently infuriating the conservative movement by co-sponsoring an immigration-reform bill with Ted Kennedy that tries to build a ladder towards citizenship. He promises to vote against making the repeal of the estate tax permanent, on the ground that America has no need of dynasties. As for his appearance at Liberty University, there is less to it than meets the eye. Mr McCain has singularly failed to mend fences with other leaders of the religious right such as Paul Weyrich (whom he once described as a “pompous self-serving son of a bitch”) and Mr Robertson. He has also refused to grant the religious right its dearest wish, support for a constitutional amendment banning same-sex marriage. For his part, Mr Falwell stresses that he is not endorsing Mr McCain either; he prefers Bill Frist or baccy-chewing George Allen. He is merely signalling that he can live with him.

What Mr McCain's trip to Liberty University is really about is a subtle but substantial change in the balance of power and ideology in the Republican Party. Mr McCain is neither a wilful maverick nor a liberal who somehow found himself in the wrong place. He is a different kind of Republican—part sunbelt conservative (who believes in limited government), and part Teddy Roosevelt Republican (who believes in using the power of the state to solve pressing problems such as growing inequality and global warming). This ideology represents a challenge to many Republican power-brokers, particularly tax-cutters and lobbyists. That is why Mr McCain provokes such a furious debate within the party. But his particular range of ideas probably presents the Republicans' best chance of winning a third presidential election in a row.

South America

The diminishing of Brazil

May 11th 2006 | BRASÍLIA
From The Economist print edition

Brazil's Lula da Silva has been humiliated by Venezuela's Hugo Chávez. But there are limits (see article) to the new giant's clout

IT HAS long been the dream of Brazil's politicians and diplomats to augment their country's stature in the world by positioning it as the undisputed leader of a united South America. But as Latin America's leaders gather this weekend in Vienna for a meeting with their European counterparts, their region has rarely looked so divided. And many Brazilians complain that their president, Luiz Inácio Lula da Silva, is being turned into an irrelevant bystander in his own backyard by Hugo Chávez, Venezuela's oil-rich populist leader.

The immediate uproar was prompted on May 1st by the decision by Evo Morales, Bolivia's socialist president, to order the nationalisation of his country's oil and gas industry. He was fulfilling a campaign promise. But he was advised, and apparently inspired, by Mr Chávez. The chief victim of his decision was Brazil. It is the largest consumer of Bolivian gas. Petrobras, the Brazilian national oil company, was the largest investor there. Brazil may now have to pay up to 60% more for the gas.

Lula's response looked feeble. Instead of asserting Brazil's contractual rights, he held a meeting not just with the Bolivian leader and Argentina's president, Néstor Kirchner, but also with Mr Chávez on May 4th. Lula said that Bolivia was acting within its rights. In return, Mr Morales offered to refrain from cutting off gas supplies and to negotiate their price.

To critics of the Lula government, Brazil's meekness unmasked the confusion at the heart of its

foreign policy. In making alliances, they claim, it has put presumed ideological affinity above national interest and a rules-based approach to regional integration. “The entire thrust of Brazilian diplomacy for the past 20 years has been damaged,” wrote Rubens Barbosa, a former ambassador to Washington, in a newspaper column.

Since Lula is likely to seek a second term at an election in October, there is some partisanship in such criticisms. Officials say that Brazil will never use a big stick against its neighbours. But there is also some foundation. Take the United States, Brazil's largest single trading partner. Celso Amorim, the foreign minister, insists that good relations are “essential” for Brazil. But according to his deputy, Samuel Pinheiro Guimarães, who is the foreign ministry's chief ideologue, Brazil must “react to the political initiatives...of the hyperpower” by “promoting political alliances with the states of the periphery.”

That has led Brazil to stress relations with countries in Africa, the Middle East and Asia, with meagre results. For good reasons, Brazil favoured the Doha round of world-trade talks over the 34-country Free Trade Area of the Americas (FTAA), sponsored by the United States. But with the Doha round floundering, Brazil is left with few alternatives.

On taking office in January 2003, Lula proclaimed regional integration to be his top foreign-policy priority. Yet Mercosur, the putative customs union established by Brazil with Argentina, Paraguay and Uruguay in 1994, has never been in greater disarray. “Brazil went for a dream of South American unity before strengthening and deepening Mercosur,” says Alfredo Valladão of Sciences-Po, a French university.

A 12-country South American Community of Nations, launched in 2004, is doomed to irrelevance by internal splits. Colombia and Peru have joined Chile, Mexico and Central America in signing bilateral trade agreements with the United States. Now Uruguay is threatening to follow suit. “Mercosur is more a problem than a solution for Uruguay,” its president, Tabaré Vázquez, said recently. Brazil has done nothing to restrain Argentina's Mr Kirchner from trying to bully Uruguay into halting two big paper mills, which he claims will pollute a shared river.

“We have not done everything we should have done for smaller economies in Mercosur,” admits Mr Amorim. The group needs an “integrated industrial policy” and a common policy on government procurement, things which require “a change in culture, especially in the bigger countries,” he says.

Mr Chávez's project is very different from Brazil's. He has signed up Mr Morales to the “Bolivarian Alternative”, his political alliance with communist Cuba. He wants nothing to do with countries that sign trade agreements with the United States. Where Brazil wants to integrate, Venezuela wants to divide. Under Mr Chávez, an elected autocrat, Venezuela has respected neither contracts nor democratic norms. Yet not only has Brazil remained silent about such conduct, it has encouraged Venezuela to join Mercosur. Such reticence to scold is partly because Brazilian construction firms have big projects in Venezuela, says Rafael Villa, a Venezuelan at the University of São Paulo.

A hard line against Venezuela would backfire, counters Mr Amorim. He says that within the limits of non-intervention Brazil uses whatever influence it has to reinforce democracy in Venezuela. That influence, he claims, is limited by the United States, which has blocked the sale of Brazilian aircraft to Venezuela. The “verbal cold war” between Mr Chávez and George Bush's administration makes it much more difficult to build bridges between Venezuela's government and the opposition, he says.

Maybe so. But Brazil has failed to articulate a clear alternative to *chavismo*. Not so long ago, its leaders had a vision of regional integration based on the outspoken defence of democracy, respect for treaties and on linking Mercosur to the world through, for example, a free-trade pact with the

EU. It is hard not to conclude that this vision is being sacrificed to a puerile impulse to embrace those who peddle the populist rhetoric of “anti-imperialism”. For that, Brazilians may soon pay a price.

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Peru's election

With friends like these

May 11th 2006 | LIMA
From The Economist print edition

Hugo Chávez's meddling backfires

ON MAY 8th, Ollanta Humala, the nationalist former army officer who won most votes in the first round of Peru's presidential election last month, met Evo Morales, Bolivia's socialist president. Opening an eye clinic staffed by Cuban doctors at Copacabana, a small town on Lake Titicaca just inside Bolivia's border with Peru, the two men proclaimed their fraternity.

So will Peru be the next domino to fall to the Bolivarian Alternative for the Americas, an anti-*Yanqui* political alliance sponsored by Cuba and Hugo Chávez, Venezuela's president, and recently joined by Mr Morales? Probably not. Opinion polls suggest that Mr Humala will lose a run-off election on June 4th to Alan García, a former president, by a margin of ten to 20 percentage points. And far from helping Mr Humala, the vocal support of Messrs Chávez and Morales seems to be hurting him.

Last month, Mr Chávez launched a verbal broadside against Mr García, calling him a “swine” and “thief”. That may be because Mr García's moderately populist APRA party has links with Democratic Action, a social-democratic party that is the Venezuelan president's oldest political foe at home. Mr Chávez has called on Peruvians to elect “Comrade Humala”, though he denies financing him. Last month, Peru withdrew its ambassador to Venezuela, for the second time in four months, in protest at Mr Chávez's “persistent and flagrant interference” in the election.

Mr García's presidency from 1985-90 is recalled with horror by many Peruvians, for its hyperinflation and rampant guerrilla violence. But he claims to have matured, and retains a sharp and clever tongue. Unlike Mr Humala, he did not need “a foreign tutor to tell me what is in Peru's best national interest,” he said.

According to the pollsters most Peruvians dislike Mr Chávez and his meddling. One poll, by Apoyo, found that only 17% had a positive view of him, and 75% disapproved of his comments. Only 23% approved of Mr Morales, and 61% objected to his calling Peru's outgoing president, Alejandro Toledo, a “traitor” for signing a free-trade agreement with the United States.

If elected, Mr García says he would ally his country with moderate governments of differing hues in Brazil, Chile and Colombia. He also offered to create a regional front to contain Mr Chávez. He may find several takers.

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Mexico's presidential election

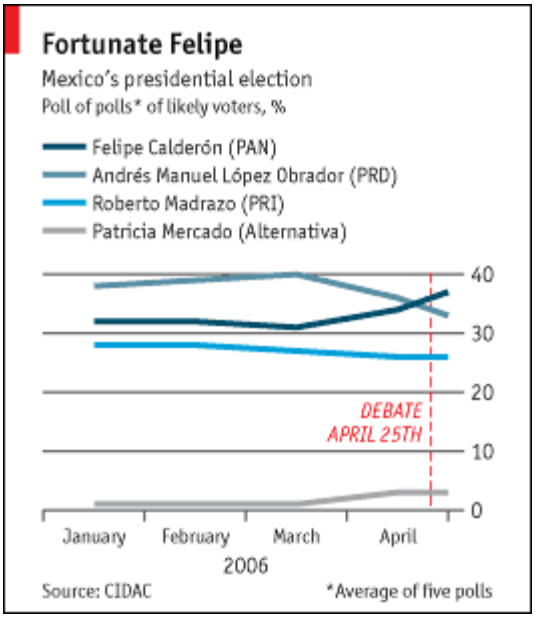
Coming from behind

May 11th 2006 | MEXICO CITY
From The Economist print edition

The rise of Felipe Calderón

"NOTHING in politics is impossible," Felipe Calderón is fond of stating. As the candidate of President Vicente Fox's conservative National Action Party (PAN) in a presidential election on July 2nd, Mr Calderón is doing his best to live up to his saying. He came from behind to win the PAN's primary in October, defeating Santiago Creel, Mr Fox's interior minister and presumptive nominee. Last month he overturned a two-year lead in the opinion polls for Andrés Manuel López Obrador, the candidate of the leftish Party of the Democratic Revolution (see chart).

This achievement probably has more to do with tactics than substance. José Espina, the PAN's general secretary, attributes Mr Calderón's rise to a campaign relaunch in March. This resulted in a barrage of negative advertising against Mr López Obrador, a populist whose political origins lie in Mexico's formerly ever-ruling Institutional Revolutionary Party (PRI). The ads claim that Mr López Obrador would visit disaster upon Mexico and link him with Hugo Chávez—despite his denials of any kinship with Venezuela's president.



Mr Calderón is conducting his campaign largely through the media, where he has outspent all his rivals. He makes far fewer public appearances than Mr López Obrador. This, says Dan Lund, a pollster, makes his lead vulnerable to an advertising counterblast from his rival.

Several other things may be helping Mr Calderón. First, Mr Fox has weighed in on his behalf with thinly disguised "public-service advertisements" trumpeting his party's achievements in government. Though opponents have cried foul, less discreet presidential campaigning was the norm during the PRI's seven decades in power. Mr López Obrador, for his part, did himself no good by declining to show up for the first of two debates between the main candidates on April 25th, allowing his rivals to ignore him.

Another factor is that the economy is picking up. Growth will be 4.5% this year, forecasts JPMorgan, an investment bank—the highest figure since Mr Fox took office in 2000. The economy is the main issue in the campaign. Mr López Obrador has stressed social justice. Mr Calderón's main pitch is faster growth, to be achieved by cutting corporate tax rates. He also promises to be more effective than Mr Fox in approving economic reforms, by forming a coalition government.

But Mr Calderón is far from home and dry. So far, he has managed to profit from an ambiguous

relationship with Mr Fox. By snatching his party's nomination from Mr Creel, he has been able to distance himself from the government's inaction, while sharing in the glow of its achievement of macroeconomic stability.

But he cannot convincingly cast himself as an outsider. While Mr López Obrador rose from humble origins, Mr Calderón, a lawyer and economist, studied at Mexico's top private universities and at America's Harvard University. He is a former energy minister and president of his party, which his father helped to found.

In the end, the race may be tipped by the performance of other candidates. Patricia Mercado, a social democrat, may steal a few left-wing votes from Mr López Obrador. More importantly, the PRI's Roberto Madrazo has fared poorly. His campaign has been hurt by party splits and allegations of sleaze. If the election turns into a two-horse race, much will depend on which way disillusioned PRI voters turn. Whoever wins may well face a divided Congress, as Mr Fox has. The more negative the campaign becomes over the next seven weeks, the harder it will be to build the cross-party coalition the winner will require to govern effectively.

NOTIMEX

Calderón fishes for votes

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Canada

Mutual aid

May 11th 2006 | MONTREAL
From The Economist print edition

The prime minister courts Quebec

PERHAPS the most surprising detail in the surprising victory Stephen Harper's Conservatives won in Canada's general election last January was that they picked up ten seats in French-speaking Quebec. The Tories' aversion to gay marriage and a firearms registry, and Mr Harper's poor French and WASP-ish demeanour, meant that few expected him to win any seats at all in the socially liberal province. This success seems to have convinced Mr Harper that Quebec is the key to giving his minority government a majority the next time Canada votes. To that end, he has been showering the province with attention.

In his first 100 days as prime minister, Mr Harper has held no fewer than four meetings with Jean Charest, Quebec's premier. Contrast that with his cold shouldering of other provincial premiers. Dalton McGuinty, who runs Ontario, the most populous province, is a Liberal like Mr Charest. He has only been able to coax 45 minutes in a hotel room from Mr Harper, and with no photo opportunity. Two of Mr Harper's meetings with Mr Charest were held at the legislature in Quebec City. That showed rare deference to the province—no other Canadian prime minister had ventured there since 1984.

Mr Harper's breakthrough in Quebec came after he promised more respect for provincial autonomy and to resolve a “fiscal imbalance” which has seen the federal government in Ottawa post big budget surpluses while several provinces are deep in the red because of the rising cost of health and education. Since taking office, he has begun to transfer more money to the provinces. He also offered to let Quebec have a representative in (but no veto at) Canada's UNESCO delegation. “It's not a chair—it's a corner of a chair,” sniffed one separatist. But others hailed the move as “historic”. Along with this have come sweet words. For example, in last month's Throne Speech Mr Harper promised to recognise “the unique place of a strong, vibrant Quebec in a united Canada.”

All the attention seems to be paying off. The latest poll—taken before the UNESCO announcement—gave the Tories 34% support in Quebec, up almost ten points on their election showing. That puts them ahead not just of the Liberals but of the Bloc Québécois, the separatist party that has dominated federal politics in Quebec since the early 1990s and won 51 of the province's 75 seats in January.

Mr Charest has not seen a similar boost to his (low) approval rating. He often seems hamfisted, as in a recent decision to sell part of a public park to developers with strong ties to his Quebec Liberal Party. Still, he can take encouragement from the waning polls of his main provincial adversaries, the separatist Parti Québécois, from 50% in December to 36%.

Mr Harper's success in wooing Quebec seems to indicate that support for independence—and those who promote it—is soft, and susceptible to federal blandishment and cash. But this courtship could easily go sour. Mr Harper's professed willingness to look again at the constitution could end

in disaster, as it did for Brian Mulroney, a previous Conservative prime minister in the early 1990s. Or the western social conservatives in the Tories' ranks could yet frighten off their new supporters in Quebec. But for the time being, with Mr Harper and Mr Charest each likely to go to the voters in the next 18 months, they look to be not only each other's best buddy but also each other's best bet.

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Paraguay

Charity or China?

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From The Economist print edition

An alliance of convenience

OF THE 25 countries around the world, all smallish, which choose to recognise Taiwan rather than China, almost half are in Latin America or the Caribbean. In the past, their motives were often rooted in shared anti-communism. Nowadays, it is usually a matter of money. So it is with Paraguay. When Chen Shui-bian, Taiwan's president, visited the landlocked South American republic last weekend he paid homage to the origins of their friendship at a reception, going out of his way to greet the grandson of Alfredo Stroessner, Paraguay's fascistic dictator of 1954-89. Then he got out his cheque book.

In the past few years, Taiwan has given Paraguay grants of $30m for public housing and $20m for a new Congress building. Other donations—only Japan and Germany are more generous—pay for scholarships. Two Taiwanese banks offered a $400m loan, making the island Paraguay's biggest bilateral creditor.

Paraguay has failed to turn this charity into a development partnership. In 1990, the average Taiwanese was three times better off than the average Paraguayan; now the gap is more than sevenfold. Of the 10,000 Taiwanese who migrated to Paraguay, many of them in the 1980s, only half remain. Taiwanese investment comprises little more than an ailing industrial park—partly because skilled labour is short. Taiwanese experts have passed on technical advice, but their lessons were ignored, says Carlos Paris, a trade official.

Meanwhile, China looms larger. Last year, it supplied a quarter of Paraguay's imports, second only to Brazil. It buys much of the country's soya crop. For some Paraguayans, such as Jorge Samaniego, whose factory assembles Chinese motorcycles, lack of diplomatic ties is becoming a problem. It makes it harder for his Chinese suppliers to visit.

Pressure to switch diplomatic recognition lay behind Mr Chen's visit. “People see China's economic boom as an opportunity, but its voracious appetite for energy and raw materials should be treated with caution,” he said. He unveiled a $250m fund to encourage Taiwanese firms to invest in the island's Latin American diplomatic allies. “We are talking about an investment plan. This is not dollar diplomacy,” said Mr Chen. Perish the thought.

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Singapore's election

Ten in a row for the men in white

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From The Economist print edition

EPA

The People's Action Party shows that it remains one of the world's most successful political machines

IT WAS a thrilling election, by Singaporean standards. For the first time since 1988 opposition parties managed to put up candidates for over half the 84 constituency seats. So in theory the ever-ruling People's Action Party (PAP) ran the risk of losing power, especially if its fears of a rebellion among well-educated young voters came to pass.

Of course, no one expected it to do anything but win handsomely. And within hours of the close of polling on May 6th, it was clear that the party had kept its unbroken record. The “men in white”—the colour of the PAP's campaign uniforms, signifying integrity—have won all ten elections since Singapore's independence from Britain (via a brief, unhappy marriage to Malaysia) in the 1960s. The party, led for decades by Singapore's founding father, Lee Kuan Yew, and now by his son, Lee Hsien Loong, raised the city-state to first-world income levels. In each election it has convinced Singaporeans it would be foolish to risk this prosperity by voting it out.

The opposition won just two seats, as in 2001, though under the rules it will again get a third, “non-constituency” seat. By agreeing not to stand against each other, the three opposition parties reduced the PAP's share of the vote in contested seats, from 75% last time to 67%. The Workers' Party came within sight of victory in Aljunied, a big “group” constituency (in which voters select a party slate of five or six candidates), gaining 44%. This was despite a row involving one of its candidates, James Gomez. Security cameras showed he had failed to hand in one of his registration papers, despite claiming to have done so. The PAP said it was a stunt to discredit the Elections Department. Since election day, Mr Gomez has been interviewed by police.

The younger Mr Lee, prime minister since 2004, was seeking his first mandate, and the PAP hoped to deliver him a clean sweep. His immediate predecessor, Goh Chok Tong, was dispatched to win over the two opposition constituencies with the PAP's customary mixture of carrots (lashings of money to improve their housing if they voted the right way) and sticks (last place in the queue for state grants if not). But neither this nor the PAP's harping on about Mr Gomez's antics worked.

Critics of Singapore's government point to its tight restrictions on political protest and its repeated use of defamation suits against the opposition and journalists. In the run-up to the election the PAP sued the tiny Singapore Democratic Party, arguing that one of its campaign leaflets had impugned the ruling party's honesty—the one thing that is guaranteed to inflame its ire. The party's leader, Chee Soon Juan, has already been bankrupted by a PAP lawsuit. Several of his colleagues, named in the new lawsuit, quickly apologised and agreed to pay damages.

Although those who challenge the PAP can expect a tough time, Singapore is by no means the hardest country for an opposition candidate to win votes in. Opposition parties were allowed to hold big campaign rallies and they got a moderate amount of coverage in the government-friendly local media. Desmond Lim, a defeated candidate of the Singapore Democratic Alliance, concedes that the fragmented opposition would do better if it united. Mr Lee senior, still in the cabinet as "minister mentor", aged 82, is harsher, saying recently that Singapore needed "a world-class opposition, not this riffraff". What is clear is that the PAP does not just win by squashing its opponents. Its tenth successive victory shows that it remains a most formidable political machine.

The reasons for the PAP's success are manifold, but the main one, as it never fails to remind voters, is that it has always kept its promise of efficient and clean government. Singapore's economy continues to grow at tigerish rates—9% in the year to March. Though Singaporeans grumble about the rising cost of living, their incomes and the public services they enjoy compare favourably with those anywhere else in South-East Asia.

But how has the PAP maintained its form, when dominant parties elsewhere have become flabby and corrupt for want of a strong opposition to keep them nimble? In part this is because of its obsession with seeking new talent, and its ruthlessness in turfing out established figures to keep its line-up of ministers and MPs fresh. Over a quarter of its candidates are new this time around; a similar proportion were new at the previous election, in 2001.

Sinapan Samydorai of the Think Centre, a group promoting political openness, says the PAP is also expert in co-opting any bright spark who might otherwise become a critic. For example, he says, Raymond Lim, now a cabinet minister, once belonged to the Roundtable, an extinct political club that briefly looked like a nucleus of opposition. The PAP puts results above ideology, which makes this easier.

Chiam See Tong of the Democratic Alliance, one of the two re-elected opposition MPs, has argued that Singapore must increasingly compete in a knowledge-based world economy and will need a "climate of freedom". As he put it, "One does not expect slaves to be creative." In the long term, he is likely to be right. But so far, the PAP's Brave New World, in which a pampered and politics-shy public is led by strict but benevolent leaders, seems to make Singaporeans pretty happy.

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Thailand

If at first you don't succeed

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Why the Thais will have to vote again

JOLTED into action by an admonishment from Thailand's revered monarch, King Bhumibol, the country's judges this week complied with his request that they find a way out of a deep political mess. The Constitutional Court ruled on May 8th that April's snap election—which failed to return a quorate parliament because of an opposition boycott—was unconstitutional and must be re-run. Since the main opposition group, the Democrat Party, has now lifted its boycott, the ruling may offer the prospect of a return to normal parliamentary politics. But several issues still have to be resolved, including the date of the new election and the future role of Thaksin Shinawatra, who stepped aside as prime minister after the disputed poll.

Since April's election, hundreds of lawsuits have been filed by opposition parties, protest groups and academics—many of them accusing the Election Commission of bias or bumbling—so the judges had plenty of grounds to choose from. They found the election unconstitutional for two main reasons. First, because the secrecy of the ballot was compromised by the positioning of polling-booths, which made it possible for one voter to peer over another's shoulders. Second, because polling day was only 37 days after the dissolution of parliament, whereas the judges said the constitution required 45-60 days' campaigning. Oddly, no one seemed to have noticed this before the poll.

Reuters

Some Thais still want Thaksin

On May 9th, Constitutional Court judges met their counterparts from Thailand's two other senior tribunals, the Supreme and Administrative Courts, and agreed that they would all oversee the new election to ensure its fairness. The Supreme Court's spokesman also urged the much-criticised election commissioners to resign. If they do, the process of replacing them, which requires confirmation from the Senate, could significantly delay the election re-run.

Candidates can stand only if they have belonged to their party for at least 90 days—so in theory, if it takes this long to organise the repeat election, some factions in Mr Thaksin's Thai Rak Thai party might take the opportunity to jump ship (or so some in the opposition hope), undermining its chances of staying in power. However, this seems unlikely to happen, if at all, until a new election date is set. So far it is unclear who decides this, though one Constitutional Court judge indicated that the government and Election Commission should do so jointly.

For his part, Mr Thaksin has been having fun with the pack of reporters that has dogged his steps since his recent return from a foreign tour. One minute he insists he is “retired” and “unemployed”, the next he briefly reassumes his official duties for a ceremony to mark coronation

day. The opposition, and the street-protest movement that demanded his resignation over allegations of corruption and abuse of power, would not be at all happy to see him return, even if he were running things from behind the scenes rather than reassuming the prime minister's job. But he seems likely, at the very least, to stand for parliament as a party-list MP.

How will this go down with the protesters? The mess is far from over.

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Australia's budget

Costello gives something back

May 11th 2006 | CANBERRA
From The Economist print edition

Tax cuts for all

Get article background

THERE was an unwelcome guest at the celebration that Australia's conservative coalition government, led by John Howard, hoped would greet the budget on May 9th, marking its ten years in power. Peter Costello, Mr Howard's treasurer (finance minister), certainly offered something to cheer about. He announced income-tax cuts worth nearly A$37 billion ($28 billion) over four years, a scale of largesse that staggered almost everyone.

But the euphoria was somewhat dampened by a decision just a few days earlier by the Reserve Bank of Australia to raise interest rates for the second time since March 2005. This was not good news for a government that won its fourth successive election in late 2004 on a campaign slogan promising to “keep interest rates low”. After commentators had absorbed the impact of Mr Costello's budget cash handouts, some immediately started asking whether they risked applying further upward pressure on inflation, and so causing yet another interest-rate rise.

Mr Costello, though, was under pressures of his own. After Australia's 14 years of uninterrupted economic growth, the government's coffers are awash with revenue earned largely from China's insatiable demand for the country's coal and iron ore. Mr Costello himself has grown rather impatient with producing budgets (this was his 11th). He still hopes that Mr Howard will retire gracefully in time to hand over the prime ministership to him before the next election, due in late 2007. But this prospect is looking increasingly unlikely. So, with a record of fiscal responsibility and a string of budget surpluses behind him, this one provided a useful chance for Mr Costello to answer calls for the fruits of the lucky country's boom to be shared more widely among taxpayers.

He lowered the top tax rate from 47% to 45% and raised the income level at which it kicks in to A$150,000; six years ago, the top rate started applying at A$50,000. The changes mean that a mere 2% of taxpayers will now pay the top rate, leaving four-fifths paying 30%. Mr Costello also delighted the horde of baby-boomers approaching retirement by abolishing tax on income from self-funded pension schemes. After all this, he still forecast a surplus of almost A$11 billion in 2006-07.

These changes were bold. But they did not altogether satisfy those who argue that the government should instead be using its windfall on things like education, infrastructure and training that will keep the economy competitive once the commodities boom starts to wane. Even Mr Costello concedes that Australia's terms of trade, the best in 30 years, have peaked and will now probably turn down.

Peter Hendy, chief executive of the Australian Chamber of Commerce and Industry, a leading business lobby, worries about a “comfortable political formula” that involves collecting big tax

revenues, then offering tax relief closer to an election cycle. “Tax relief is not tax reform,” he says. Trends that encourage Australians, already bloated with household debt, to spend more also seem to worry the central bank. Ian Macfarlane, its governor, cited solid growth in domestic spending among the reasons for raising interest rates on May 3rd by 25 basis points to a cash rate of 5.75%. Having at last paid down the government's own debt, Mr Costello has plenty to smile about. Another rate rise stemming from this budget would spoil the party.

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Japan's succession

After he's gone

May 11th 2006 | TOKYO
From The Economist print edition

Who will replace Junichiro Koizumi?

IF THERE is one Japanese politician already well into the post-Koizumi era, says a protégé, then it is the prime minister himself. Junichiro Koizumi, who has held office for five iconoclastic years, promises to step down in September in order to enjoy good food and music once more—not to mention a private life. But already, says the young parliamentarian, the divorcé prime minister's heart is on all those things.

Only six months ago, Mr Koizumi still looked at the top of his game. But a financial scandal that implicated his party has gravely dented his authority, as has a row over his attempt to change the rules on imperial succession to allow for the possibility of a female emperor. With little drive from the prime minister, what remains of Mr Koizumi's reform agenda has stalled. The Diet (parliament) is in session at least until mid-June, but little business is getting done. Even the main legislative goal for the ruling Liberal Democratic Party (LDP) this session, passing an education bill that promotes the teaching of patriotism in schools (a long-time obsession of cultural conservatives), looks like not passing in time. The prime minister, just back this week from a tour of west Africa and Sweden, appears to have in his diary only one event to which he looks forward—a summit in June with President George Bush meant to mark the reinvigoration of the security alliance between America and Japan.

It leaves a curious hiatus in Japan's governance, for the bid to succeed Mr Koizumi is not likely to begin for real till the Diet winds up. Still, the nature of the race is already changing in intriguing ways. For instance, with Mr Koizumi a limping duck, it is no longer clear how powerful his endorsement might be for any would-be successor. This is especially so now, since a new factor that has crept into the race is the issue of Japan's diplomatic isolation in the region—to which Mr Koizumi's visits to the Yasukuni shrine, symbol of Japan's past militarism, have greatly contributed.

Usually, foreign policy is not high on Japan's political agenda. Besides, a reservoir of approval for Mr Koizumi's visits exists among the LDP's many hawks. So the change reflects the degree of party concern about Japan's poor international standing; and a number of undecided party factions, as well as potential kingmakers such as the economy minister, Kaoru Yosano, now demand to know what candidates intend to do about it. This does not help the cause of the front-runner, Shinzo Abe, the 51-year-old cabinet secretary. He is a long-time supporter of Yasukuni visits, and in the new mood this could be a liability. This week, Keizai Doyukai, a club for corporate executives that is close to the LDP, became the first big business group to give public warning of Yasukuni's danger to business with China.

By the same token, the odds have improved for Yasuo Fukuda, a grand old party man who belongs to the same faction as Mr Abe. His late father, Takeo, when prime minister in the 1970s, articulated the “Fukuda doctrine” of conciliation with Japan's Asian neighbours. Late last month, Mr Fukuda called for a fresh diplomacy in Asia that built on his father's beliefs. The speech seemed

to mark his bid for the leadership. Meanwhile, a long-odds successor to Mr Koizumi, Taro Aso, the foreign minister and another Yasukuni-goer, recently declared that when it came to sensitive issues, national interest should trump private beliefs.

On the economy, the differences among candidates turn on whether a rise in the consumption tax is needed to plug a gaping budget deficit and bring down the high levels of debt incurred when Japan tried to spend its way out of slump in the 1990s. Mr Abe insists that revived growth and lower government spending will plug the gap. The finance minister, Sadakazu Tanigaki, is less disingenuous. He says that a hefty increase in the consumption tax is needed sooner rather than later—which probably explains why Mr Tanigaki is already considered the least plausible of the four probable main candidates.

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India's elections

Left turn

May 11th 2006 | DELHI
From The Economist print edition

Local voters like the Communists

IN INDIA as elsewhere, all politics is local. In its federal system, elections for the legislative assemblies of its constituent states have no direct impact on the make-up of the central government. But central policies are often influenced by these campaigns, and the results play a big part in determining the political strength of the parties in Delhi. So there was enormous interest in the outcomes, declared on May 11th, of the elections for four state assemblies (Assam, Kerala, Tamil Nadu and West Bengal) and one small "union territory" (Pondicherry). A by-election in the parliamentary constituency of Rae Bareli in the state of Uttar Pradesh also caused a stir, because it involved Sonia Gandhi, leader of the ruling Congress party.

The clear winners from these very different contests were the Communist parties, which are not part of the Congress-led coalition in Delhi, but provide from outside the votes it needs for a parliamentary majority. In West Bengal, the Left Front led by the CPI (M), the largest of the Communist parties, which has ruled the state since 1977, returned to power for the seventh time, with an even larger majority.

CPI (M) leaders gloated that this was a triumph unique in India, where incumbent governments are rarely re-elected. This time, too, there will be fewer accusations of vote-rigging and intimidation than at previous elections, thanks to a robust campaign by the independent Election Commission. The CPI (M) seems to have picked up new votes from the urban middle classes. They have been impressed by the state's chief minister, Buddhadeb Bhattacharjee, who has not let communist ideology weaken his enthusiasm for more investment and development.

A Communist-led coalition also won in the southern state of Kerala, where its victory seemed almost as inevitable, for the opposite reason: elections there always bring a change of government. Since 1980, power has alternated between the Left Front and the Congress-led United Democratic Front, a pattern of discontinuity blamed for contributing to the state's lack of economic progress.

Analysts say the results in West Bengal and Kerala will strengthen the Left's hand in Delhi. Already, the front has blocked some reforms the government of Manmohan Singh, the prime minister, would like to pursue—such as further privatisation, a relaxation of India's restrictive labour laws, or a cut in the government's huge subsidy bill. But it is unclear how much the elections really have bolstered either the Left's resistance to reform, or its bargaining position.

Some of its posturing up to now has been aimed at voters in these elections. And it is not likely to bring the government down by floating a “third front” government with small regional parties.

Congress still benefits from the disarray of the main opposition, the Bharatiya Janata Party, and could take comfort from the other election results this week. In the important southern state of Tamil Nadu, a coalition led by Congress's partner, the Dravida Munnetra Kazhagam, defeated one led by the incumbent chief minister, Jayaram Jayalalitha, a controversial film star turned politician. The election was notable for spendthrift promises. The DMK offered free colour televisions; Miss Jayalalitha countered with personal computers for needy students and gold for brides.

On May 11th, as *The Economist* went to press, a Congress-led coalition in Assam seemed likely to buck the state's anti-incumbency tradition, while in Pondicherry, the party would rule by itself. Mrs Gandhi was heading for the expected landslide. She had provoked the by-election by resigning her seat in a controversy over her apparently breaking rules by holding an “office of profit”—heading a National Advisory Council. Her children, Rahul and Priyanka, helped her campaign, which skilfully exploited the local popularity of the Gandhi dynasty.

Many in Congress hope that the Gandhi family will now use its charisma to help re-establish the party elsewhere in Uttar Pradesh, India's most populous state, and hence the key to winning more seats in Parliament in Delhi. Until it can do that, the party seems doomed to be at best the centre of a coalition government, fighting constant battles with its own partners.

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China and tourism

Golden years

May 11th 2006 | BEIJING
From The Economist print edition

Coming soon to a luxury store near you

GOOD news for a country trying to promote domestic consumption: record numbers of Chinese tourists travelled around their own country during a seven-day national holiday last week and spent record amounts of money. But it is the swelling numbers of big spenders taking holidays abroad that excites China's neighbours and many Western countries most. How long, though, will either boom last?

The numbers look promising. Officials estimate that excursions within China during “golden week” numbered 146m, up 20% over the same period last year. Income from tourism grew in nominal terms by more than 25% to some $7.3 billion, with domestic travellers spending an average of about $50 each, up around 4%, or 3% in real terms.

China has not released figures for visits abroad during the May Day holiday. But officials have predicted that the total number, for both business and leisure, would rise to some 35m for the whole year, an increase of 12.9% (see chart). By 2004, they say, China had already become the biggest source of travellers within Asia. The World Tourism Organisation reckons annual visits abroad from China could rise to 100m within 15 years. And Wang Shan of CContact, a British tourism consultancy, says that 150m Chinese are already affluent enough to take holidays abroad.

Around 90% of visits are still to other Asian destinations, including Hong Kong (part of China but in effect abroad as far as tourists are concerned). But tourism agreements reached with EU countries in the past couple of years have boosted travel to Europe. Canada is hoping for a similar deal in the coming months. Although Chinese tourists often eat cheaply and avoid the most luxurious hotels, Western luxury retailers see an exciting new source of custom. A slight strengthening of China's yuan since last year and a recent easing of its controls on buying foreign currency could make them even more willing.

Two of the biggest attractions for Chinese tourists, Taiwan and the United States, are still beset with problems, however. America worries about the potential for illegal immigration if it makes tourism too easy, while with Taiwan the difficulty is deeply political. Last month, in an overture to the island, China's government said it would allow travel agencies to organise tours to Taiwan. Taiwan also expressed a willingness to open up, albeit still with a quota. But, as ever, actually starting talks about the issue is proving a big obstacle.

Aid to the Palestinians

Seeking a bypass, as the money runs out

May 11th 2006 | GAZA
From The Economist print edition

The Quartet moots a way of mitigating Palestinian hardship. But nobody knows how, or whether, it is going to work

AP

EVER since March, when foreign donors first began cutting aid to the Palestinian Authority (PA) in the wake of Hamas's election victory, their refrain has been that they did not intend to punish the Palestinians personally. This week they acknowledged that the punishment was happening anyway. The so-called Quartet (America, the European Union, Russia and the UN) has proposed a "temporary international mechanism" to avert a humanitarian disaster by sending aid directly to the Palestinian people. The unspoken assumption is that this scheme will restore at least some of the money for PA salaries, while bypassing Hamas, which the donors do not want to deal with until it meets the Quartet's conditions of recognising Israel and renouncing violence.

Some 29% of the Palestinian population depend on PA salaries, and they have gone largely unpaid for two months. The effects are clearly visible. In Gaza City, the rush-hour traffic jams are a shadow of what they used to be. Shopkeepers and stallholders on the usually bustling Omar Mukhtar street stand idle, except for the jewellers who field steady trickles of people wanting to sell wedding rings and family silver. Vegetables and fruit are starting to rot as customers hoard their cash.

There are shortages of fuel—which will only increase now that the Israeli provider to the PA has suspended supplies because it had not been paid—and also of dairy products and medicines, largely because, since the start of the year, Israel has kept the Karni goods crossing-point between it and Gaza closed almost as often as it is open. The crossing has been targeted by terrorists, and the PA, under Israel's instructions, has been digging for alleged tunnels there. So

far it has found nothing.

The world's blockade of the PA has hit harder and quicker than anyone expected. In March, the World Bank predicted cuts in aid, trade and the number of work permits for Palestinians in Israel, and forecast that Palestinians' average incomes—already low in the wake of the *intifada*—would fall by another 30% this year alone. In fact the cuts have been much deeper than foreseen, and banks are caving in to American pressure not to send the PA money from other sources. In a report this week the bank says that even its original gloomy forecast now looks “too rosy”.

Locals say they are still a few weeks away from running out of money altogether. But PA institutions are showing the first signs of shutting down. Some departments have told staff they need not turn up or can work from home. Gaza's state-run university has closed its doors for a week. Grant Leaity, the field co-ordinator for Médecins Sans Frontières, worries that “nurses will be among the first people to look elsewhere for jobs”.

That would cripple the Health Ministry, the main provider of health services, which was already running out of some medical supplies because a big funding programme from the World Bank expired last year. This week four kidney patients in Gaza were reported to have died for lack of dialysis. Another immediate risk is that rival clans and political factions with influence over the various bits of the PA's security services will stoke the unrest already felt by unpaid and disgruntled members.

If the PA stops functioning, says the World Bank, the result will undo years of institution-building. The bank gives warning that the crisis “could lead the public to look for basic services, such as education, from informal and less secular providers.” It adds that “institutional paralysis could also increase calls by the Palestinian public for wrapping up the PA and handing administrative responsibility back to Israel.”

Israel definitely does not want that. It welcomed this week's Quartet proposal. But the mechanism for providing aid is still a pretty vague notion. One idea is to channel the wage money through the office of the president, Mahmoud Abbas, who is not from Hamas. But most people agree that his office simply lacks the capacity to handle it. Another is to set up a trust fund with an independent payments agent, as was done in the mid-1990s when the PA began. But that could take precious time. A third is to beef up the World Bank's existing Emergency Services Support Programme, which provided the Health Ministry money that ran out last year.

Equally unclear is how much money, and for what, the donors actually want to give. If the total sum is not enough to cover the whole of the PA's bloated payroll, who—other than the PA itself—can decide which salaries really need paying? And will it cover anything besides wages? More than half the Health Ministry's budget, for instance, goes on expenses like fuel, medicine and equipment. Without them, paying the nurses will do little good.

In any case, the bank says, there is not much point in a bypass mechanism unless Hamas itself agrees, and so far its reaction has been hostile. It is almost equally important that Israel, too, gives way, by releasing the $55m-60m a month in tax and customs revenue that it collects on the PA's behalf but has been holding in escrow since February. On May 10th Israel said it was willing to release 50m shekels ($11m) through a Quartet mechanism for humanitarian uses, but not towards the $95m monthly wage bill.

As the Palestinians wait for help, Israel continues to pound the northern Gaza Strip with up to 300 artillery shells a day, in response to rocket fire from Palestinian militants. While the militants' crude rockets have done virtually no damage in Israel, the shells, though usually aimed away from populated areas, do damage houses, and injure and occasionally kill people with their shrapnel. The continuous thud of shelling, audible several miles away in Gaza City, puts everyone even more on edge than they were already.

Iraq's new government

A task for the honest and brave

May 11th 2006 | DUBAI
From The Economist print edition

The awful scene that the new men will be facing

AP

The relative calm in Basra

WITH Nouri al-Maliki, Iraq's new prime minister, on the verge of creating what many hope will be the first national unity government, the unrelenting violence of the past week provides continuing evidence of the immensity of the task in front of the new ministers. How will any government hold the confidence of Shia Arabs, Sunni Arabs and Kurds?

Insurgents set off car bombs, killed and kidnapped. Blindfolded or handcuffed bodies, thought to be the victims of sectarian killers, were found dumped in abandoned properties or by the sides of roads. On May 7th suicide-bombs and other explosions killed 30 people in Baghdad and the holy city of Karbala; on May 9th 17 people were killed by a bomb blast in Talafar, a northern town; on May 10th 11 workers at an electricity plant were killed by gunmen who seized the bus they were travelling in north of Baghdad. This list is merciless.

The Interior Ministry also reported the discovery of 51 corpses, casting doubt on American claims that the surge of sectarian violence touched off by the demolition of a Shia shrine in February may be ebbing. Jalal Talabani, Iraq's president, quoted a morgue report that nearly 1,100 people were killed for sectarian reasons last month in Baghdad alone. Iraqi officials say that up to 100,000 people, both Sunnis and Shias, may have fled their homes to escape being attacked. That exodus will create yet another source of sectarian grievances.

Basra, in the south, became a scene of particular violence at the weekend after a Lynx helicopter crashed in the city, killing five members of Britain's armed forces. Five Iraqis, including a child, were killed in the mêlée (it is not sure by whom) when British soldiers rushed to the scene and were met by a mob throwing stones and petrol-bombs. The dominant political forces in Basra are

a handful of Shia Islamist movements, thought to maintain both their own independent militias and networks of loyalists within the police. A subgroup of the radical Mahdi Army, a militia led by Muqtada al-Sadr, has been taking potshots at British forces. The helicopter crash suggests they may have got lucky.

Such incidents reaffirm that the south of Iraq, though not as violent as the Sunni centre, is still chaotic. Once Mr Maliki forms his government, America and Britain are set to begin talks on whether Britain can start withdrawing troops, passing security in the region to local officials. The latest clashes can either be taken to indicate that the British are not wanted and should go, or that the job is far from done and they should stay. British officers say that their continued presence is helping to build a professional Iraqi police force, both by training honest officers and by arresting militia-affiliated or corrupt ones. They point out that the police came promptly to the Basra crash site and helped cordon off the area, a task they might not have been able to do a few months ago.

Some of the insurgents, for their part, may be expressing a certain dissatisfaction with the way their revolt is going. In the course of a raid, American soldiers claim to have discovered a letter, purportedly written by radicals affiliated with al-Qaeda. In this, the writers complain that the cells in Baghdad are unable to move beyond hit teams and car-bombs, opting for “noisy operations” that attract media attention but do not establish control over places or institutions, and do not challenge the dominance of the Shia-led government. At least they are not short of a bob or two. Recent reports by American and Iraqi auditors suggest that billions of dollars' worth of cash from stolen oil products are sloshing about the country, giving insurgents, militias and criminals both the means to sustain themselves and a motive for maintaining the status quo.

Thanks to insurgent sabotage and administrative paralysis, electricity output fell last month to four hours a day in Baghdad, as low as it has been at any time since the lights first came back on after the war. If the new government is to get anywhere, Mr Maliki and his allies will have to try to do three simultaneous things: hunt down the insurgents; rebuild the faltering state apparatus; and root out corruption. Failure to advance on any one of these fronts would cripple all chances of success.

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Iraq's Kurds

Brotherly embrace

May 11th 2006 | ARBIL
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Unity at last, in one corner of northern Iraq. Now for autonomy

IT HAS taken eight years of hard bargaining—and the removal of Saddam Hussein—but Iraq's feuding Kurdish barons are now formally at peace, with a single government for their self-ruled region. The re-unification of the two administrations, one headed by the Kurdistan Democratic Party (KDP), led by Massoud Barzani, and the other by the Patriotic Union of Kurdistan (PUK), led by Jalal Talabani, was approved last weekend by the 105 members of the Kurdistani parliament in Arbil. The new government will have a 32-member cabinet, drawn largely but not exclusively from KDP and PUK ranks, and will mirror the portfolios of ministries in Baghdad.

Mr Barzani and Mr Talabani have ruled most of northern Iraq since the Americans kicked Mr Hussein out of Kuwait in 1991. But fratricidal war in the mid-1990s split the region into two one-party statelets: the north-west run from Arbil by the KDP; the south-east from Sulaymaniyah by the PUK. The internecine guns fell silent after an American-brokered peace deal in 1998 but the cold war continued, until now.

At a grand unveiling ceremony, Mr Barzani, who is president of the Kurdistan region (Mr Talabani is president of Iraq), said the breakthrough heralded a new era, not only for Iraq's Kurds but also for the other sects and ethnic groups who live in what has become the country's most stable and prosperous area. Pleased to escape the pressure-cooker atmosphere of Baghdad, a host of foreign ambassadors—from America, Britain, Russia, China, even Iran—came north to lend their weight to the occasion. Only the sulking Turks stayed away.

Mr Barzani expressed the hope that the new unified Kurdish administration would help the central government in Baghdad in its bid to realise political stability, security and, perhaps most elusively, unity. His remarks seemed aimed at the gaggle of senior figures from Iraq's quarrelling Sunni and Shia communities who had also made the journey north.

The Kurds are hoping to persuade their Arab compatriots to embrace the federal provisions contained in the country's new constitution. Mahmoud Osman, an independent Kurdish politician, argues that unity will give the Kurds more leverage as they seek to consolidate their desire for autonomy—as well as a better chance of extending the boundaries of their region to include the contested city of Kirkuk.

Some Shia politicians have already demanded for the south the same broad powers that the Kurds now have in the north, including an independent parliament, ministries and army. This is

provoking much heat. The Kurds, after all, are suspected of aiming at secession. Iraq's Sunni Arabs fear that if the Shias ape the Kurdish model by establishing a “Shiastan” in the south, it could leave the oil-poor Sunnis alone with their palm trees and sand.

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Dubai

Dubai does aid, too

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The plushest of new homes for the international aid industry

THERE were mixed feelings at a humanitarian trade fair held recently in Dubai. On the one hand, sellers of everything from blankets to body armour were delighted to be in on a booming business. On the other, business depended on other people's misfortunes. So, although company directors insisted that their products alleviated suffering in hellish spots (which they mostly do), they were also banking on a rapid growth in misery and disaster, particularly in Africa.

The trade fair was the largest of its kind ever. Not only that, but it was held in Dubai rather than Geneva, long closer to home for the international army of NGOs. The emirate hopes to offset its materialist image by making itself a global hub for the aid industry. Boosters, hoping to lure NGOs with the city's tax-free status, low-cost housing for aid-workers and hotels where they and foreign correspondents can hunker down on their way to emergencies, promise that a “humanitarian city” will be available in Dubai by 2008. Geography is certainly on their side: Dubai is close to disaster-prone bits of Africa and Asia.

That a city mainly associated with luxury tourism is pitching for NGO custom, and NGOs are listening, also shows how quickly the aid business is changing. Traditional headquarters for aid agencies, such as Oxford and Bordeaux, now seem a long way, perhaps too far, from their client base. NGOs are also moving closer to Dubai's business-oriented thinking. People at the fair traced the more hard-nosed approach back to a decade ago, when NGOs started hiring procurement officers with industry experience. Logisticians, who work out how to store and move aid, became more professional.

The change has important consequences. Shoestring aid operations, those with plenty of heart but not much common sense, are no longer welcome in disaster areas. Similarly, middlemen are in decline. A famine or an earthquake used to be a boon for traders. Now, NGOs buy directly from specialised manufacturers. Chancel International, an Egyptian-based supplier to the Red Cross and others, can ship tens of thousands of cooking kits, for instance, within hours of an order. Over the course of an extended emergency, in Darfur, for instance, it might supply several million items.

The question is whether a more business-like approach may also affect the way NGOs choose their projects. An increasing number of heretics would like to see a venture-capital examination of projects. That is not a solution in itself, they admit, but it is more likely to get a better deal for increasingly limited funds, particularly in Africa. They also want to see more MBAs hired by NGOs. A new base in Dubai, with lower costs, may help their cause.

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Iran and America

Of God and men

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From The Economist print edition

Relying on the prophets

Get article background

THE diplomatic effort to defuse the gathering crisis over Iran's nuclear ambitions is sufficiently stuck that anyone involved (bar China's godless Communists) might have been tempted to invoke the Almighty. Yet the litany of taunts and complaints in a letter from Iran's president, Mahmoud Ahmadinejad, who chose to address President George Bush this week—the first such direct communication between the leaders of the two countries since Iran's 1979 revolution—as one believer to (he had heard) another, hardly seems likely to break the impasse.

Instead, after a tough meeting between the foreign ministers of America, Britain, France, Germany, Russia and China at the United Nations, the European three prepared to huddle to find more material inducements to get Iran to suspend its enrichment of uranium (which it claims it needs for producing electricity and others suspect may be a cover for bomb-making). The idea is to present Iran with a clearer alternative: more promises of trade, help with nuclear power and access to fuel from other sources, or face the prospect of sanctions—which Russia and China have so far been reluctant to contemplate.

Mr Ahmadinejad gave no sign Iran will budge over enrichment. Why is it, he asked, “that any technological and scientific achievement reached in the Middle East” is “portrayed as a threat to the Zionist regime?” It isn't: the Europeans and America have said they have no problem with Iran, like others in the region, using nuclear energy for peaceful purposes.

What they object to is the most dangerous technologies in the hands of a regime that lied for 20 years to nuclear inspectors and that threatens Israel. “Let us assume these events are true,” says Mr Ahmadinejad, doubting that the Holocaust ever took place; what right, he mused, does Israel have to exist in the region?

Along with criticisms of the war in Afghanistan, the invasion of Iraq (though Saddam, he acknowledges, was a “murderous dictator”) and the pressure on the Hamas government in Palestine to recognise Israel, this seems designed to win support in the Arab world. To plenty of Iranians, though, his championing of the oppressed of Africa and Latin America may seem a bit rich from the president of a regime that treats its own opponents roughly. According to Human Rights Watch, an NGO, at least two of Mr Ahmadinejad's ministers have been involved in systematic abuses of human rights, including executions of dissidents.

What is Mr Ahmadinejad up to? Suggesting that American officials may have helped instigate the attacks of September 11th seems aimed to cause offence, at a time when America is being pressed to consider direct nuclear talks with Iran and some of Mr Ahmadinejad's rivals at home have shown interest. Might the invitation to “return to the teaching of prophets” have less to do

with concern for Mr Bush's soul, and more with bolstering Mr Ahmadinejad's political power on earth?

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South Africa

One challenge down, one to go

May 11th 2006
From The Economist print edition

Cleared of rape, Jacob Zuma can now focus on the corruption charges

Get article background

AFP

Zulu celebrations for Zuma

AS SOUTH AFRICA marked the tenth anniversary of its democratic constitution on May 8th, Jacob Zuma, the country's former deputy president, had extra reasons to celebrate. Following a three months' trial, Judge Willem van der Merwe concluded that sex between Mr Zuma and the 31-year-old HIV-positive woman who accused him of rape was, in fact, consensual. Mr Zuma, who suspended his duties as deputy leader of the ruling African National Congress (ANC) when he was charged in December, could now resume his high-profile role in the party. The favourable verdict is a boost for Mr Zuma, but the trial has seriously dented his credibility by exposing his recklessness. In July, he also faces another trial for corruption. Those charges had led directly to his sacking as the country's deputy president last June.

Mr Zuma's supporters, who had mounted a vigil outside the court ahead of the decision, were ecstatic, and there was much singing, dancing and cheering outside the Johannesburg High Court. The ANC and its political partners, the Communist Party and the Congress of South African Trade Unions, jointly expressed relief that the trial was over; Mr Zuma's judicial tribulations have created tensions within the ruling political alliance, as his supporters maintained he was unfairly treated and the victim of a conspiracy.

The opposition Democratic Alliance, on the other hand, commented that Mr Zuma had displayed “some of the worst aspects of patriarchy and sexism” during his trial. The fact that the former deputy president, who once led the country's top HIV/AIDS council, had unprotected casual sex with someone he knew was HIV-positive provoked passionate reactions in a country in the midst of an AIDS pandemic. His testimony that he took a shower to “diminish the risk of infection” infuriated those struggling to contain the spread of the disease. The threats that his supporters dished out against his accuser also outraged women's groups; she may have to go into exile abroad, out of fear for her life in South Africa.

Even Mr Zuma sounded contrite afterwards, publicly apologising for having unprotected sex. He says he remains committed to fighting AIDS and promoting women's rights, and that his accuser should not be vilified. That may repair some of the damage done to his credibility and, if cleared of corruption, he might yet be a strong presidential candidate. And even if his testimony in this trial does kill his own presidential chances, he could still carry a lot of influence when the ANC decides next year who will succeed President Thabo Mbeki in 2009.

However, the implications of the trial go beyond Mr Zuma's political fate. It also ignited much debate over traditional patriarchal attitudes and sexual violence in a country with a fearsomely high incidence of rape. The discussion may help speed up the passing of the long-delayed Sexual Offences Bill, which seeks to improve legal processes related to rape cases. It could also re-energise women's-rights groups and their cause, in spite of their disappointment at the verdict. Last week, Mr Mbeki said he thought the country's next president should be a woman; Mr Zuma's successor as the country's deputy president happens to be one.

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Russian nationalism

Playing a dangerous game

May 11th 2006 | MOSCOW
From The Economist print edition

Alarmist rhetoric from President Vladimir Putin; skinhead violence on Russian streets. Is there a connection?

Reuters

Get article background

A FEW days before Vladimir Putin's state-of-the nation address on May 10th, a strange, seemingly unrelated apparition presented itself in a Moscow park: some 50 Africans, plus the odd Afghan and Iraqi, carrying rakes. They came to perform a *subbotnik*—an old Soviet tradition of voluntary civic work. They headed for a wooded glade favoured by barbecuing Muscovites, and began clearing leaves and rubbish. “Good on them,” said an elderly Russian park cleaner. “Friendship between the nations is very important.”

Unfortunately, the idea of international friendship, like the near-defunct tradition of the *subbotnik*, is less popular in Russia than it was. At the annual Victory Day parade in Red Square on March 9th, Mr Putin attacked “those who...try to sow racial hatred, extremism, and xenophobia.” Well he might: his country is experiencing a plague of racist murder and violence, often committed by neo-Nazi gangs. “The drunks just beat you,” says Romeo, from Cameroon. “The skinheads kill you.” He and his fellow leaf-rakers wanted to underline their contribution to city life. Most have stories of beatings; all avoid the Moscow metro, even in daytime.

Scant consolation though it might be, there are other victims—including Russia's ancient scapegoat, the Jews. Nine were stabbed in January in an attack on a Moscow synagogue. People

from the Caucasus and immigrants from Central Asia are also frequent targets, in what is now a nationwide phenomenon. The latest foreign fatality in Voronezh, a university town in central Russia, was a Peruvian (foreign students are drawn to Russia by cheap university fees, but are increasingly taking fright). Two people were killed when an armed gang attacked a Roma camp in the Volgograd region last month.

Beautiful St Petersburg, where Mr Putin will host world leaders at the G8 summit in July, rivals Moscow as the capital of race hatred. A Senegalese student was shot there last month—"the clean-up of the city continues," crowed an extremist website. Anti-racist campaigners and homosexuals have also been attacked. A Russian Orthodox priest recently blessed agitators outside a Moscow gay club.

Some see the viciousness as the reincarnation of old Russian neuroses that a combination of internationalist rhetoric and strong security services had managed to suppress during Soviet times. Oscar, from Burundi, studied in Moscow in the Brezhnev era and says discipline was the difference. "If I hate you, and nobody is protecting you," he says, "I can attack you." But others see the street violence as an extreme manifestation of a newer, broader trend—one evident, in a different way, in Mr Putin's state address.

Victory Day was not the first time that Mr Putin has publicly denounced racism and xenophobia. Yet, as a recent report by Amnesty International catalogued, police, prosecutors and courts remain too slow to recognise racist crimes and too lenient in their punishment. Typically, the killers of a nine-year-old Tajik girl in St Petersburg were recently adjudged to have been motivated by "hooliganism" rather than racism (another nine-year-old, the daughter of a Malian, was stabbed in the throat in St Petersburg, but lived). A racist attack on an official from Russia's north Caucasus in Moscow last month was also classified as hooliganism, until officials were shamed into thinking again.

The devil you know

One plausible explanation for this reticence is an old-fashioned reluctance to admit problems, especially, in a country that justly regards itself as Nazism's vanquisher, the growth of fascism. Dmitry Dubrovsky, of the European University of St Petersburg, says that some officials in his city detect a conspiracy by outsiders to shame St Petersburg. But another theory, endorsed by Vladimir Lukin, Russia's human-rights ombudsman, is that many in the security services secretly sympathise with the skinheads (Mr Dubrovsky agrees that this is true in St Petersburg of many ordinary officers). The police themselves harass ethnic minorities, often to extort money: ten Africans were said to have been detained at a metro station on their way to the Moscow *subbotnik*.

Attitudes in the security services are not unusual. At the last count, 52% of those polled by the Levada centre supported the idea of "Russia for the [ethnic] Russians"; large numbers confess to hostile feelings to Chechens, Roma and others. "Go into the metro," says Ma from Guinea-Bissau, "and even the children call you nigger." Russian children, she says, will not play with hers. A nationalist tendency is evident in attitudes to the rest of the world, too: friendliness towards America and western Europe is declining. It is an odd moment for Russia to assume the ministerial presidency of the Council of Europe—which is, moreover, about to publish a critical report on the country.

A new hostility to the West is not surprising, given the Kremlin's foreign-policy tone. Meddling foreign powers and spying human-rights workers have been reviled. Relations with several neighbours—Georgia and Ukraine, but also Poland—were poisonous, and those with America strained, even before Dick Cheney's critical speech in Vilnius last week (greeted by the Moscow

media as a harbinger of a new cold war, but also as evidence that Mr Putin's policies were working). “We see what's happening in the world,” Mr Putin said cryptically on May 10th, in a speech otherwise focused heavily on the declining birthrate. “As the saying goes, comrade wolf knows who to eat and he eats without listening to others.” Less cryptically, he said the arms race was still on.

The relationship between this rhetoric, the Kremlin's bid to revive national pride using tsarist and Soviet symbols, and the hate on Russia's streets, is murky. Alexander Verkhovsky of the SOVA Centre, a Moscow think-tank, sees all of them as different manifestations of feelings of imperial nostalgia. Others think Mr Putin is deliberately tolerating, even cultivating, radical nationalism as a political tactic. Vladimir Ryzhkov, an independent member of parliament, says that Mr Putin may see himself as an emperor, but not as a *Führer*. Grigory Yavlinsky, a liberal politician, argues that the Kremlin is trying to appeal to nationalist instincts but also to portray itself as the country's only defence against them. The security services seem more concerned by leftist groups than rightist ones (some of which profess loyalty to the Kremlin). Meanwhile, liberal politicians are often labelled “fascists.”

From the pogroms of the 19th century to the intermittent racism of the Soviet Union, Russian rulers have tried to manipulate nationalism for their own ends. If that is the Kremlin's game, it is a risky one, and not just for the beleaguered immigrants—as the Kremlin may already have discovered. The Motherland party is widely thought to have been created by the Kremlin in order to drain votes away from the Communists in the parliamentary election of 2003. It was banned from participating in December's local election in Moscow after it ran an anti-immigrant advertisement with the slogan, “Let's rid our city of rubbish.” But Motherland's real crime, many thought, was not being too offensive—but becoming too popular.

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France and the environment

Bear necessities

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A row between farmers and greens in the Pyrenees

UNTIL the revolution, the right to hunt bears was a perk of the nobility. But the arrival of *citoyens* with guns spelt disaster for brown bears. They soon vanished from the Vosges and the Massif Central. Today, France's only bears—numbering just over a dozen—are roaming the Pyrenees. And a plan to boost the numbers has kicked up a stink.

Last month, two Slovenian brown bears, named Palouma and Franska, were let loose in the Pyrenees. Nelly Olin, France's environment minister, plans to add five new brown bears—four females and one male—to the area, to boost the genetic pool and ensure the local survival of the species. She claims to be replacing bears that died since a release ten years ago, and to be observing France's obligations under international conventions on biodiversity. The disappearance of the brown bear is, she adds, “inevitable if we do nothing.”

Local sheep farmers have a different view. Many still leave their herds untended up in the mountains during the summer. The government paid compensation for 406 livestock losses last year, 119 of which were definitely killed by bears. The compensation scheme, say farmers, shows that the government understands the risks. Besides, the brown bear is not endangered: there are 50,000 in Europe, mostly in Russia.

The stand-off threatens to turn nasty. Anti-bear protesters disrupted the recent release of Palouma, so it had to be done in a secret location. Recently 12 pots of honey with bits of glass in them were found near the spot where Franska was set free. Anti-bear groups have been trying to stop the government releasing the other three bears, but a court ruled this week that it should go ahead.

Given President Jacques Chirac's fondness for farmers, his wild-bear programme seems surprising. That the bear controversy is providing light relief from his deepening political troubles is fortuitous. But the president must also know how removed the suburban French are these days from the realities of upland farm life. Some 58% of those even in the Pyrenees told one poll they supported bear reintroduction, and the figure for the whole country was fully 72%.

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Italy's new president

Left forward

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From The Economist print edition

How a former communist found himself becoming a president

GIORGIO NAPOLITANO, who was elected to the Italian presidency on May 10th, will be an imposing, if somewhat austere head of state. But, his personal qualities apart, there are two reasons to welcome, and two reasons to regret, his elevation. Most importantly, it promises to end the uncertainty created by last month's general election, in which the centre-right secured more popular votes in Italy but the centre-left more parliamentary seats. Mr Napolitano is expected next week to ask the centre-left leader, Romano Prodi, to form a new government that could be in place by the end of the month.

The second reason for welcoming Mr Napolitano is that he represents another step towards the integration of former communists, who were excluded from office during the cold war. Latterly, Mr Napolitano was a moderate communist; indeed, with his courtly manner, he was a rather unlikely one. But he was a leading figure in the old Italian Communist Party until its dissolution in 1991.

By then, he was already of an age when most people retire. He is now 80 and will be 87 by the end of his term. That is one cause for regret: his election consolidates the gerontocracy running Italy and stifling the intake of sorely needed new ideas. Mr Prodi's appointment as prime minister will mean that the top four jobs in Italian public life have gone to men with an average tally of 71 birthdays.

The second cause for regret, at a time when Italy is divided into two mutually distrustful camps, is that Mr Napolitano was the choice of just one. The centre-left leadership felt its presidential candidate had to come from the Democrats of the Left (DS), the successors of the Italian Communist Party. This was because the DS, the biggest party in the centre-left alliance, failed to win either of the speakerships of the parliamentary chambers. Having just fought a “reds under the bed” election campaign, the centre-right's leader, Silvio Berlusconi, felt he would lose credibility if he backed a former communist as president. The resulting deadlock lasted for three rounds of balloting and was broken only on the fourth, when the rules allowed Mr Napolitano to be chosen by a simple majority.

The new president will no doubt try to rise above party politics. But his decisions will inevitably be vulnerable to claims of partisanship. And his election will do nothing to deter Mr Berlusconi from arguing that a “bogus majority” is taking power and that he and his allies are justified in resorting to extra-parliamentary methods to combat it. Twice this week, Mr Berlusconi has threatened to promote a tax strike if the centre-left acts in a way he considers damaging for the country. That is perilous talk—and nowhere more so than in Italy.

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Germany's labour market

A lesson from Tony Blair

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From The Economist print edition

The Germans quarrel about a minimum wage

GERMAN leftwingers generally see Britain as a den of rapacious free-market capitalism. So it was striking this week that members of the British low-pay commission were greeted in Berlin with open arms by such traditional lefties as Oskar Lafontaine, the Left Party's parliamentary leader, and Andrea Nahles, a leading Social Democrat. Their interest in British labour-market policies reflects a debate over what to do about Germany's army of low-paid workers and long-term unemployed. To some, Britain's minimum wage, combined with wage subsidies, offers a model.

At first blush, the minimum wage introduced by Tony Blair's Labour government in 1999 looks appealing. Globalisation has led to greater inequality in Germany. Between 1997 and 2004, the share of German workers earning "low pay", as defined by the OECD, rose from 16% to over 20%, says the German Institute for Economic Research in Berlin. The government's original plan was just to introduce wage subsidies for the long-term unemployed, who make up more than half of Germany's 4.7m jobless. But if such payments are not to become an incentive to pay even less (making the government pay more), some argue that a statutory wage floor is needed as well. Indeed, Germany is unusual in not having a minimum wage (see chart).

Yet it is always risky to import reforms from another country—even Britain—because in a different environment, they may have unintended consequences. Germany's labour market is far less flexible than Britain's, despite a raft of reforms in recent years. The minimum wage seems not to have raised unemployment in Britain; but it could easily do so in a more rigid economy such as Germany's.

In any case Germany has a de facto minimum wage, set by the level of benefits for the long-term unemployed. A single person out of work for over a year gets an average of €650 ($825) a month, about €5 an hour. Because he can work illegally on the side and needs an incentive to take a job, a potential employer must pay at least €10 an hour, says Hilmar Schneider, of the Institute for the Study of Labour in Bonn. For families the figure is even higher, as they get extra unemployment benefits.

Believers in a minimum wage say it ensures that people can earn a decent living. And if set at a lower level than in some other countries—say €7.50 an hour, which the unions have called for—it need not cost jobs. Yet the German economy is not as dynamic as others. Also, many of Germany's low-paying employers are small companies in the east that cannot afford higher wages,

not least because they compete with firms in lower-wage Poland.

What is more, the institutional set-up would be different. In Britain, a government-appointed commission fixes the minimum wage, and it has done so cautiously. In Germany, with its tradition of collective bargaining, the wage floor is likely to be set in negotiations between unions and employers. These groups have shown before that they are willing to raise wages at the bottom, even if that means pricing low-skilled workers out of jobs.

Such complications are not lost on the government. Franz Müntefering, the Social Democrat labour minister, already seems to be backtracking on the minimum wage. He may end up proposing only to introduce a few more sector-specific minimum wages, which already exist in construction and some other industries. Yet some see a minimum wage coming, because existing and planned in-work benefits would otherwise become too costly.

The heated debate about a national minimum wage will have served a purpose, even if it never happens. It may bring closer the realisation that Germany must get its labour-market incentives right, for instance by adopting more widely and strictly another British labour policy, pioneered by America: workfare, when welfare benefits are paid only if recipients engage in some activity, such as a training programme or a socially useful job. But, unlike the minimum wage, workfare is anathema to Germany's traditional left.

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Spain and immigration

Still they come

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A new route, but an old problem

IT HAS been another difficult week for the guardians of Spain's frontiers. Last weekend more than 460 sub-Saharan illegal immigrants reached the Canary Islands in large, fragile fishing-boats that had set out from west Africa. In the first four months of 2006, the number reaching the islands has already passed the total for all of 2005. Some 5,000 people have come, following a new and highly dangerous route which starts in the faraway ports of Mauritania or Senegal. Officials say that as many as 1,000 immigrants may have drowned on this route in the past six months alone. “They are willing to take quite enormous risks,” comments Rickard Sandell, at Madrid's Elcano Royal Institute.

AP

We're all going on a Spanish holiday

Like a liquid flowing downhill, illegal immigrants naturally take the path of least resistance. Dam the river, as Spain and others have found, and it eventually trickles around the obstacle, however big. “It is the traffickers who keep an eye out for the difficult places, and try to avoid them,” says Gemma Pinyol, of the CIDOB Foundation in Barcelona.

Spain is the nearest thing that the European Union has to a frontier with Africa. The gap between the mainland and Africa is just nine miles (14km) at the Strait of Gibraltar. There are also direct land borders at the Spanish north African enclaves of Ceuta and Melilla. In contrast the closest Canary island to Africa, Fuerteventura, lies some 100km from the coast.

Over the past decade Spain has placed ever more obstacles along these frontiers. When boatloads of immigrants began arriving on beaches near Gibraltar in the 1990s, it installed an early-warning radar system based on one that Israel developed to stop seaborne Palestinian guerrilla raids. When groups of immigrants pushed their way into Ceuta and Melilla, fences were erected. They

were strengthened last year, after the existing ones were stormed by hundreds of would-be immigrants.

Spain has worked hard abroad as well. It has persuaded African countries to help. Morocco patrols its side of the frontier more efficiently. Mauritania is prepared to do the same. The barriers, plus the help from African governments, have made it much harder for immigrants. But they have clearly not stopped them. The latest wave has, once again, flowed around. What was once a voyage of under 20km across the Strait of Gibraltar can now be more than 1,000km from ports in Senegal. Since Fuerteventura has now installed an early-warning system, the new targets are Tenerife and Gran Canaria. Some of the latest batch of arrivals had sailed from Senegal, the Spanish government's delegate on the Canaries told local journalists. The journey was thought to have taken them a week or more.

All the signs are that the numbers of would-be immigrants are likely to rise further. The population boom in much of sub-Saharan Africa is far outstripping economic growth. “We are seeing the tip of what could become a much bigger problem,” says Elcano's Mr Sandell. He adds that, if Spain were to become too successful at blocking its frontiers, immigrants would simply shift their efforts to Italy or other European countries. “Spain is the nearest frontier but, given the risks they take, I would not exclude much more extended travelling across the Mediterranean,” he says. “It is probably more of a European problem than a Spanish problem.” The solution, if there is one, may have to be European as well.

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The euro

When to join, and when not to

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Small countries should adopt the euro—if they can

IN THEORY, the European Union has a bracing and rational membership regime. Getting in means meeting Brussels standards in everything, from aviation to zoos. Once in, members take the next step, joining the euro, when they have slain inflation and sorted out public finances.

Reality is different. The three small countries that hoped to join the euro soonest are all solvent, and have creditably low inflation. But only one, Slovenia, strictly meets the criteria for new members, and is therefore likely to get the nod. The finance minister, Andrej Bajuk, looks forward to the end of exchange-rate risk, and says it both signals the “maturity” of his country's economy, and proves that the euro is not an “elitist, impenetrable club”.

For Estonia and Lithuania the story is not so good. Both countries fail (in Lithuania's case by less than a decimal point) the criterion that new members must have inflation no more than 1.5% above the average of the three lowest rates in the EU. In March, these came from Finland, Poland and Sweden. Yet the resulting target, of 2.6%, is artificial, since Poland and Sweden are not in the euro. A fairer test, argues Charles Robertson of ING, a bank, would be the average of the three lowest inflation rates in the euro area, which would mean a target of 3%.

The European Central Bank and European Commission will publish their assessment of would-be entrants next week. Estonia has put its plans on hold. Its problem is double-digit growth, which would normally be reflected in a rising exchange rate. But the Estonian currency has been pegged since 1992, so rapid growth is expressed in rising prices instead. Lithuania is still trying to get in, despite warnings that it won't succeed. Rolandas Krisciunas, a deputy finance minister, says his country will be “somewhat puzzled” by a negative ruling. It will press its case when the EU's finance ministers decide in June. “It doesn't make sense for us to stay out. It doesn't make sense to keep us out,” he says.

Yet many politicians in old Europe think the single currency has quite enough members already, having stretched the rules for countries like Greece. They worry that giving Lithuania even the teeniest wiggle-room would set a deplorable precedent. Big countries like Poland and Hungary, with soggier public finances, may then want exceptions too.

In fact, these countries are sensibly warier than they once were about early euro entry. Smaller countries with vulnerable currencies need the euro more. They cannot realistically have an independent monetary policy, and they gain from making trade cheaper and easier. It also makes them safer, notes Edward Parker of Fitch, a ratings agency. Their growth is stoked by big current-account deficits. Outside the euro, a crunch could be damaging.

One oddity in this tale is that many existing euro members, notably France, Germany and Italy, now fail the criteria on public finances—yet nobody throws them out. An even bigger curiosity is

that the inflation and public-debt criteria make little economic sense. The real test for joining the euro should be whether an economy is flexible enough to cope with the strain of a permanently fixed exchange rate. On that score the bigger central European countries—and, indeed, big existing euro members—have much work still to do.

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Charlemagne

A case of enlargement fatigue

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Hostility to expansion of the European Union reflects displaced fears of globalisation

EUROPEANS are in a funk about enlargement. National politicians fret about the European Union's "absorption capacity". They hold grand conferences on "the limits of Europe". The EU has just suspended the first stage of accession talks with Serbia. Next week, the European Commission is likely to postpone judgment on whether the next two candidates—Bulgaria and Romania—should join in 2007 or be delayed until 2008.

Partly, these decisions are efforts to get the candidates to speed up reforms (and, in Serbia's case, to hand Ratko Mladic, a war-crimes suspect, over to The Hague tribunal). But they also reflect a widespread view, in Brussels and even more in national capitals, that expansion must be slowed down to respond to "enlargement fatigue".

Many politicians have decided that public opinion is irrevocably opposed to enlargement. They think that opposition is understandable, if not justified, because of the impact of enlargement on jobs; that enlargement has gone too fast; and that another round may overwhelm the EU's institutions, making them unable to function. They conclude that it would be best for all concerned (including future members) to pause while everything settles down. Indeed, this is the emerging conventional wisdom. Yet it is wrong in almost every particular.

Europeans are not opposed to enlargement in general (though they may be to the specific case of Turkey). A slim majority is in favour. A new poll by the European Commission's public-opinion arm has more people saying that enlargement is a good thing for the EU (55%) than that the EU is a good thing for their own countries (49%). If national politicians were serious about reflecting

public opinion, they should be calling for a pause in all activities of Brussels, rather than in further expansion of the club. It is not clear that enlargement fatigue is really about public opinion at all.

What is clear, in contrast, is that the 2004 enlargement to the east has produced net benefits for Europe, increasing trade, investment and income. In principle, there could still be winners and losers. Opposition to enlargement might be concentrated among the losers, just as support is strongest in the three member states—Britain, Ireland and Sweden—that have opened up their labour markets to new members. But in fact enlargement's impact on jobs in countries most vehemently opposed to expansion (eg, France) has been minimal, partly because the French have insulated themselves from it and partly because French unemployment is a self-inflicted wound, not the result of competition from central Europe. In short, although some people blame Polish plumbers for taking their jobs, there is no evidence that this is actually happening.

Has enlargement gone too fast? It took 15 years from the fall of the Berlin Wall for the first ex-communist countries to join the EU—three years more than the time between Franco's death and Spain's accession. Has it made the EU's institutions unworkable? So far, the EU has functioned broadly as well—and as badly—with 25 members as it did with 15. Nor is all the EU's money being gobbled by regional aid for new members: in 2007-13, the share of the budget going on regional support falls, while the share going to farming rises. The big internal divisions in the EU remain what they have always been—ie, between old member states (most often Britain and France). The only time a new member has set itself against the rest of the EU was when Poland held up a decision on VAT rates, which is hardly evidence of widespread institutional dysfunction. In general, predictions that enlargement would do all manner of harm have not materialised.

Perhaps most important, the EU is not about to be overwhelmed by a second wave of expansion that might explain some of today's fears. The admission of Bulgaria and Romania is a coda to the enlargement of 2004, not a prelude to something new. No country seeking to join will be ready to do so in the next year or two (Croatia might be ready by about 2010, Turkey not until long after that).

The conclusion is that the public reaction against enlargement does not reflect fears about what any prospective expansion might actually do. It reflects, rather, doubts about what previous rounds have done. It is backward- not forward-looking. And those doubts are irrational, because the charges levelled against enlargement are mostly untrue or exaggerated.

Globalisation blues

This suggests that enlargement fatigue really reflects something more deep-seated than the issue of expanding per se. And that something seems to be a fear of the change that is associated with globalisation.

That same recent EU poll found a striking correlation between countries that say globalisation is a threat and those that blame enlargement for threatening their jobs. In France, 72% of respondents were fearful on both counts. Austria, Germany and Belgium came near the top of both lists. But the old member states most relaxed about enlargement also tend to see globalisation as an opportunity, not a threat. Enlargement fatigue seems to be one of globalisation's discontents.

That does not make it easier to deal with. But it suggests that slowing the process down may not do much to ease enlargement fatigue. And it would certainly damage the EU's interests among applicant countries, in the Balkans and beyond, where opponents of “Europeanisation” are quite happy about talk of enlargement going too far. Moreover, it cannot alter enlargement's fundamental logic—that it benefits existing and new members alike, and that failure to enlarge can

carry big costs of its own. If the EU does not go to the Balkans, the Balkans will come to the EU, in the form of illegal immigration, drugs and crime. In short, it will make no sense to let in two parts of the former Yugoslavia (Slovenia and then Croatia), while keeping the rest out.

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Correction: Lithuania

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In our April 29th issue, Charlemagne said that Lithuania was “even smaller” than Slovenia. In fact it is bigger, in both population and area. Sorry.

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Politics

Bloodied and slightly bowed, Tony Blair battles on

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Under pressure from events and his own MPs, the prime minister has edged towards naming the date for his departure

Reuters

AT FIRST sight, not much has changed. Tony Blair is still prime minister, and he is overwhelmingly likely to remain so until he chooses otherwise. The most likely date for his departure is, as before, sometime between May 2007, when he celebrates his tenth anniversary in Downing Street, and the Labour Party conference in the autumn. But it doesn't feel like business as usual. The events of the past week have changed the political landscape.

The local-government elections on May 4th were always destined to be bad for Labour, and they were. Rumbling scandals over the alleged sale of honours, hospital deficits, the sexual shenanigans of the deputy prime minister and the release by the Home Office of countless foreign prisoners who should have been up for deportation all took their toll.

The pattern of Labour's rebuff has changed since 2004, the last time there were council elections. Then, Labour lost most ground among its traditional supporters. This time, it was the newer elements of the electoral coalition that had brought Mr Blair to power, especially in the south-east and around London, who expressed their dissatisfaction with high taxes and poorly performing public services. The result was a swing from Labour to the Conservatives that gave the Tories, under their new leader, David Cameron, nearly 40% of the vote and their best local-election result since 1992. Mr Cameron's achievement is to have made his party, not the Liberal Democrats, the main beneficiary of Labour's unpopularity.

For Mr Blair, the message was clear: what was needed was more New Labour reforming zeal, not

less, and he reshuffled the cabinet accordingly. But Labour MPs returning to their constituencies at the weekend to meet defeated councillors and furious activists heard a different story: Mr Blair had become an electoral liability, and any recovery in the party's fortunes was dependent on his quitting.

In anticipation, a number of supposedly centrist MPs and former ministers—not the “usual suspects” on the left who oppose the prime minister in everything—had begun gathering signatures for a letter demanding that Mr Blair set out a timetable for his departure. As news of the Westminster plot spread, Mr Blair's hope that his extensive reshuffle might be seen as a vigorous assertion of prime ministerial authority was dashed. His critics and most newspapers portrayed it as a desperate last throw of the dice and an attempt to pack the cabinet with cronies.

In fact, it was one of Mr Blair's better reshuffles. He had no choice but to relieve the hapless Charles Clarke of his duties at the Home Office, and stripping John Prescott of his departmental responsibilities while leaving him as deputy prime minister should have happened long ago. At education, Alan Johnson is likely to have a surer political touch than Ruth Kelly did. And there is nobody better-equipped than Jack Straw, the new leader of the House of Commons, to press on with reforming Parliament, a point missed by those who want to believe that Mr Straw was removed from the Foreign Office to placate American neo-conservatives intent on nuking Iran. The promotion of Douglas Alexander to transport and Des Browne to defence should have pleased Gordon Brown—both are Scots and close to the chancellor.

Less skilful, however, was Mr Blair's letter to the newly-appointed chairman of the Labour Party, Hazel Blears, asking her to begin an overhaul of the party machine. Mr Brown's supporters were not amused. As Mr Blair was not going to fight the next election, they protested, why was re-organising the party anything to do with him?

After a weekend of headlines about plots and ultimatums, an embattled Mr Blair decided to face down his detractors, first at a press conference and then at a private meeting of Labour MPs. He rejected arguments that he should make clear the date of his departure, which he said would only help the Tories. But the prime minister acknowledged that the concerns about his leadership were not confined to those in the party who had always loathed New Labour. He emphasised that there were still things he wanted to do—among them sorting out pensions, embedding public-service reforms and establishing a long-term energy strategy. He was, he said, committed to an orderly transition of power and to giving his successor “ample” time to establish himself before the next election.

By all accounts, Mr Blair's meeting with his MPs was a tense affair. There was grudging acceptance that a formally announced timetable—the letter drafters' objective—was asking too much, but there had to be visible evidence that Mr Blair and Mr Brown were working together to make the transition a success. An early test of their new team spirit will be whether they can cut a deal on pensions. MPs also came away convinced that Mr Blair would be off sometime next year.

A loose, *de facto* timetable now exists, which it would be foolhardy for the prime minister to ignore. This is underlined by the grim findings of two opinion polls this week: one put Labour eight points behind the Tories, while the other gave Mr Blair an approval rating of 26%—lower even than Harold Wilson's in 1968 after he had devalued the pound. Yet those who would like to see things happen faster have been forced to accept that pressing their case for Mr Blair's early departure would do more harm than good to the party.

But John Denham, a senior backbencher who has become something of a party bellwether, warns that if Mr Blair is to have another year, he's got to do better. It's not entirely clear how Mr Denham defines virtue in this context. Although he describes himself as New Labour, he is a critic of Mr Blair's school and health reforms. The third reading of the education bill is imminent and

there could well be a trial of strength over amendments that are unpalatable to the government. If Mr Denham and those like him expect Mr Blair to be amenable to their point of view, they may be in for a disappointment.

The other threat to Mr Blair's freedom to manoeuvre comes from the process of transition that he will now have to embark upon. It is not clear why earlier negotiations broke down in February: Mr Blair's representatives—Alastair Campbell, once his communications chief, and Philip Gould, his polling guru—were known inside Number 10 as his capitulation team. One possible reason is that Mr Brown's people were greedy for too much power too soon. Mr Blair's view is that there can be only one prime minister and, for now, he is that person. There is still plenty of potential for things to go wrong again.

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The British National Party

The new localism

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Why the far right scored in Barking and Dagenham

Get article background

DID the far-right British National Party (BNP) do as well as expected in the local elections last week? In the run-up to the vote, pundits predicted that voters' urge to give a mid-term kick to Labour, plus a Conservative Party that was failing to talk tough on immigration, might allow the thuggish BNP to make a breakthrough. The row over foreign prisoners made that all the more probable: news of foreign rapists on the loose through government incompetence hardly needed the BNP's usual poetic licence to sell the party's message—that immigrants are criminal scroungers who threaten the culture of white British men and the chastity of their womenfolk.

Strip out the result from one council, however, and the BNP had a mediocre night. The party gained around 20 council seats out of some 4,400 that were up for election. It went nowhere or backwards in the north-west and Yorkshire, where it was popular in the past. Its candidates fared slightly better in the West Midlands. Overall, however, the BNP still has fewer councillors than the Green Party, which most deem too small to merit much attention.

But in Barking and Dagenham, on the eastern fringe of London, the picture is different: the BNP won 11 seats there and is now the main opposition party. What happened?

Three things have to come together for the BNP to do well. The first is a population that is whiter (and poorer) than average. In more ethnically mixed areas, white voters either get on with their neighbours or move out. Second, the council ward must border on an area where there are lots of non-whites. Third, the less political competition there is among the three big parties, the better for the BNP. It thrives in rotten boroughs.

All three coincided in Barking and Dagenham, which is poor, white, next to the borough of Newham (where only 34% of people are white and British) and was previously stitched up by Labour. The Tories and the Liberal Democrats have skeletal organisations there and just one councillor between them. The BNP also ran a particularly successful scare campaign that seemed to explain changes that voters could see going on around them. The council, the party said, was paying African immigrants £50,000 ($93,000) each to buy property.

Blacks and south Asians are moving out of inner London as they become richer. Nick Lowles of Searchlight, which campaigns against the BNP, says that 80-90% of property for sale in Barking and Dagenham is being bought by ethnic minorities. And the borough is short on housing. Voters saw black people moving into scarce houses and thought that the council was subsidising them.

The BNP is unlikely to find many microclimates that are so welcoming. And it often loses seats in elections that follow a coup. Richard Barnbrook, the party's leader in Barking, may already be in

trouble: on May 10th the *Evening Standard* reprinted a story about a “gay porn” film he once directed. Mr Barnbrook denies it was pornographic, but the affair will not please BNP supporters.

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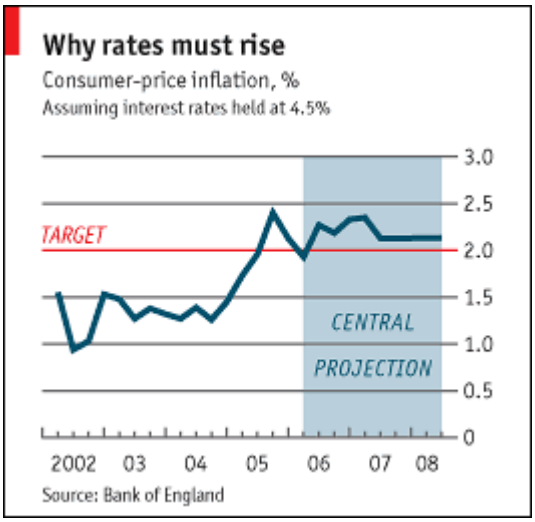
Interest rates

They're heading up

May 11th 2006
From The Economist print edition

The Bank of England sends a signal



WHEN the cost of borrowing was lowered last August from 4.75% to 4.5%, the City confidently expected that more cuts would follow. Instead, rates have stayed stuck since then at 4.5%. This week it became clear that the next move will be up rather than down.

The Bank of England signalled tighter money in its quarterly *Inflation Report*, published on May 10th. Its new projections show that if rates were held at 4.5%, consumer-price inflation would stay above the government's 2% target over the next two years (see chart). However, if rates rose to 4.75% within the next year, as the market expects, inflation would return to the target in the spring of 2008. The Bank looks this far ahead when deciding monetary policy because it takes a couple of years for interest-rate changes to have their full impact on inflation.

Britain's economic prospects are now worse than the unusually benign outlook that the Bank painted in its last report three months ago. Then, on the basis of rates at 4.5%, it forecast a robust recovery in GDP growth with inflation virtually glued to the 2% target. Now, it is signalling not only that rates will have to rise but also that growth will be a bit slower and inflation higher over the next couple of years.

Adding to the bad news for borrowers, Mervyn King, governor of the Bank of England, warned homeowners that house prices still seemed “remarkably high” compared with benchmarks such as average earnings. The Bank would “look very carefully” at what was going on in the housing market, which had picked up more strongly than expected.

Despite the revival in housing, consumer spending is forecast to grow a little more slowly than in the Bank's February report, as higher energy costs squeeze budgets. The traded sector, however, will give a fillip to GDP growth thanks to the economic recovery in the euro area, which purchases half of Britain's exports. That will be a welcome step towards a better-balanced economy after a decade in which consumers have held sway while exporters have struggled. And although the growth forecast is a bit lower than it was three months ago, the Bank no longer thinks, as it did then, that the risks are tilted to the downside.

The Bank's main worry appears to be the persistent pressure on overall inflation from higher energy costs. With fuel bills at the pump and for the home surging, inflationary expectations are

moving up. The Bank's own survey recently showed a sharp rise in the rate of inflation that the public expects a year on, from 2.2% last November to 2.7% in February.

Looking further ahead, another concern is that broad money (M4) is growing at an annual rate of 12%, having accelerated sharply over the past two years. The Bank estimates that this rate of growth is over three percentage points higher than is sustainable over the long term. The excessive monetary growth is a worry. As Mr King said on May 10th, “in the long run, if you have rapid broad-money growth, you are going to get inflation.”

For some time, inflation has tended to be lower and growth higher than the Bank has expected. But over the next two or three years, inflation may instead be higher and growth lower, as the economy adjusts to the shock of higher oil prices.

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The July bombings

What the spooks knew

May 11th 2006
From The Economist print edition

Two post mortems on the July 7th bombings avoid finger-pointing

WHAT went wrong last July 7th to allow four men to detonate bombs in London, killing themselves and 52 innocents? Two reports released on May 11th are the closest Britain is likely to come to a published answer, on the lines of the report by America's September 11th commission. But their tone and conclusions are quite different. America's report was eloquent and scathing, missing no opportunity to point out clues overlooked or warnings unheeded. Britain's efforts, by contrast, are cautious, modest and deferential.

The deadly attacks of July 7th caught the intelligence services off guard. Two months earlier, the spooks had said that there was “no suggestion of a current tangible threat to UK rail or underground”. They were especially surprised by a suicide attack. The accepted wisdom had been that Britain did not have a critical mass of extremists or a pervasive Muslim culture, and that the kind of long-term indoctrination that is needed to produce suicide bombers was therefore almost impossible.

The bombers who struck on July 7th did not come from out of the blue. The spooks had the telephone number of Jermaine Lindsay, a convert who killed 26 people on a Piccadilly Line train. Two others, Shazad Tanweer and Mohammad Sidique Khan, had come to their attention in 2004, when the men were thought to be planning an insurgency in Pakistan. Britain's domestic security service, known as MI5, resolved to find out more about the pair, but its attention was soon diverted elsewhere.

The parliamentary Intelligence and Security Committee concludes that nobody is to blame for last July's atrocities except the bombers themselves. MI5 was stretched thin and obliged to make difficult judgments about which potential plotters ought to be closely watched. It is still stretched, despite rapid hiring: MI5 expects to have 3,500 officers by 2008, up from fewer than 2,000 in September 2001. Last summer just over half were working on Islamist terrorism but they had identified some 800 “primary investigative targets”. It takes between 20 and 30 officers to watch a suspected terrorist around the clock.

The solution so far has been to keep a close eye on those who seem to pose an immediate threat, and watch the rest from a distance. It's a sensible approach, but people who do not appear dangerous one month may be ready to set off a bomb the next month. As a second report released by the Home Office reveals, the July 7th attacks were probably planned in five months or less, and cost no more than £8,000 ($15,000). The bombers made mistakes and took risks, such as writing dud cheques.

Neither report is likely to mollify the victims' relatives or those MPs who have called for a public inquiry into the bombings. The authors neither point the finger at intelligence failings nor identify the Iraq war as the ultimate cause of the atrocities. But while the reports are emotionally

unsatisfactory, so is the continuing threat posed to Britain by Islamist terror. Achieving what Americans call “closure” will be next to impossible.

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Unruly academics

Anarchy in academe

May 11th 2006
From The Economist print edition

A pay dispute threatens graduate jobs

SUMMER is never easy for Britain's university students, coinciding as it does with the stress of exams. This year, however, the stress is all the other way. Locked in a bitter pay dispute with their employers, lecturers are refusing to set papers and have not marked coursework since March, though students are begging them to do both. Many exams have been cancelled, and those that have not may never be graded. Three-quarters of students who are supposed to graduate this summer could leave without final degrees. Talks between lecturers' unions and their universities broke down on May 8th.

University teachers—more than two-thirds of whom belong to a union—complain that their pay has fallen compared with pay for similar jobs by 40% in the past 20 years. They want a 23% raise over three years. Average salaries of about £35,000, they claim, have not kept pace with the earnings of legal or medical professionals (although they put the schoolteachers' average, £25,000, in the shade). Lecturers are also sore that university vice-chancellors have seen their pay increase by 25% over the past three years. They claim that the government intended a third of the increase in tuition fees which starts next September to be earmarked for staff pay.

The universities counter that they are in fact offering more than a third of their new money. They also dispute the unions' pay figures. Using numbers from the Office of National Statistics, they say that full-time professionals in higher education in fact earned an average of about £40,650 last year, while all professionals earned some £36,890. They reckon that their latest pay offer—12.6% over three years—is generous. Poorer institutions, they argue, are stretched to their limits.

The National Union of Students (NUS), which represents some 165 university unions, has also got itself into a pickle. It supports the lecturers' action, even though a recent poll by Opinionpanel found that eight out of ten students opposed it. This week 35 student associations, including those at Bristol and Exeter universities, contacted their teachers' union branches, urging them to cut a deal locally. Between 12 and 15 of the student unions are talking of breaking away altogether from the NUS, while others threaten to reduce the dues they pay. Under pressure, Kat Fletcher, the president of the NUS, asked the members of the Association of University Teachers on May 11th to halt the exam boycott.

So far most universities are hanging together. Last week, however, the Scottish universities of St Andrews and Aberdeen broke ranks, offering lecturers slightly better terms. Union members at St Andrews accepted the deal but then withdrew after talking to their national office.

But universities are clearly becoming desperate, and the arrival of at least four firms of ambulance-chasing lawyers keen to persuade students to sue for breach of contract can only make them more so. Essex University says it will consider negotiating on its own if the dispute continues. East Anglia has asked solicitors to mark exam papers. Others are exploring whether

they can award degrees without final exams. One Scottish university has written to staff warning that they could be sued or dismissed and others are docking lecturers' pay.

The man who may have to sort out the mess is Alan Johnson, named education secretary in the cabinet reshuffle last week. Mr Johnson, once a canny trade-union leader, was minister for higher education two years ago when Parliament approved top-up fees. Mr Johnson suggested then that a third of the proceeds should go to increasing staff numbers and pay.

Mr Blair wants to raise the proportion of young people who attend university from 43% now to about half by 2010. But by increasing tuition fees to pay for the expansion, he has turned students into consumers who are beginning to demand more and better teaching for their buck. If they are going to pay for it, they want higher education to guarantee them a flying start in the job market. Feeling betrayed by their universities and their lecturers, some final-year students may now be wondering whether they should have applied instead to be apprentices of Sir Alan Sugar, an entrepreneur who thinks degrees stunt creativity and prefers to employ bright school-leavers.

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Anti-social behaviour

Mad dogs and Englishmen

May 11th 2006
From The Economist print edition

A clue to why Britain has the toughest anti-social behaviour laws in Europe

Up to no good, and who's to stop them?

FOR many years, Philip Howard evangelised shoppers in London's Oxford Street, urging them to reject the devil and “be a winner, not a sinner”. Wind and rain did not silence him; nor did insults or entreaties to turn down his megaphone. But last week the devil scored a temporary victory over Mr Howard, in the form of an Anti-Social Behaviour Order (ASBO). For the next three years, the preacher will have to rely on his God-given amplification system, or face punishment that could, in theory, run as long as a five-year prison term.

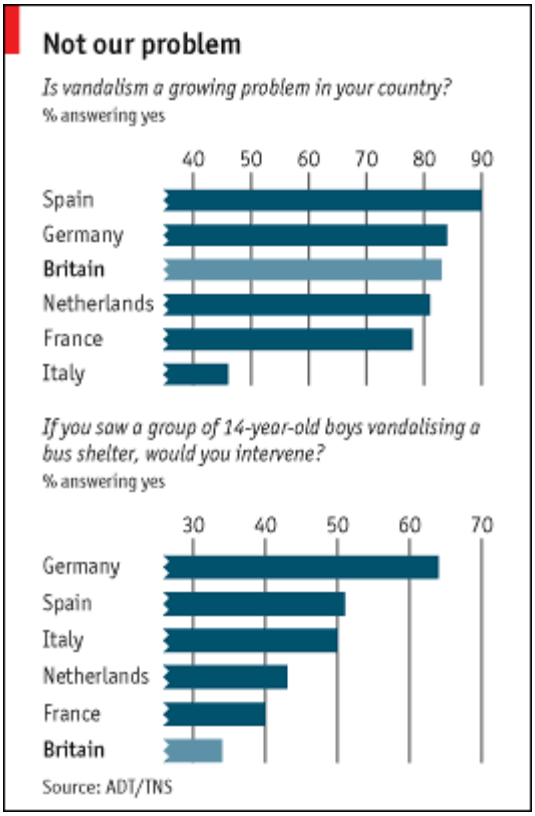
Nowhere is anti-social behaviour such a prominent political issue as in Britain, and nowhere are the laws against it so potent. Since coming to power in 1997, the Labour government has forged more than a dozen legal weapons to combat the petty incivilities that are thought to corrode society. They range from on-the-spot fines to “dispersal orders”, which can be used to expel people from designated areas, to ASBOs. These can be dished out to anyone—including children as young as ten years old—who causes harassment, alarm or distress to anyone else.

Britain's hard line is popular, and puzzling. As a poll commissioned this week by ADT, a security company, reveals, Britons are no more worried about anti-social behaviour than the residents of other west European

countries. Italians excepted, everybody frets roughly equally about such things as loutishness and vandalism, and is about as likely to believe things are getting worse (see chart). Why has only one country launched a crusade against it?

One reason is language. No other country has a term quite as all-encompassing as “anti-social behaviour”, which has been used to label everything from drunken violence to flyposting. Germany has “asozial” behaviour, but that is a tricky tag because it is associated with totalitarian attempts to define who is part of society and who is not, according to Johannes Feest, a Bremen criminologist. And as for the Spanish, they “could hardly understand the question”, according to Gloria Laycock, a criminologist who was involved in the research.

The other difference is that the British feel powerless to deal with anti-social behaviour themselves, and so expect the police to do it for them. Just 34% claimed they would intervene to stop a group of children vandalising a bus stop, compared with 43% of the Dutch and 64% of the Germans. They seem to believe that the little hoodlums will turn on them, and they may be right. When the last reliable international survey was conducted, in 2000, Britain had western Europe's highest violent-crime rate.



Fear alone did not drive Britain's crusade against anti-social behaviour. Nor did a new expression for it or the belief that petty incivilities are somebody else's problem. Together, though, these three things have proved a powerful force. A government that is keen to respond to popular concerns has been given a free hand in drawing up unusually tough powers, which can be used to tackle problems great and small. Mr Howard is just one victim: neither a sinner nor a winner.

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Real-estate investment trusts

Of bricks and tax breaks

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From The Economist print edition

Britain's property companies go tax-free

ENTOMOLOGISTS could hardly be more excited at the discovery of a new butterfly than Britain's property investors are at the introduction next year of Real-Estate Investment Trusts (REITs). Shares in quoted property companies, which just three years ago traded at an average discount to assets of 45%, now trade at a premium, according to Morgan Stanley, an investment bank. Much of that gain is due to the simple fact that, from next January, listed property companies will be allowed to turn themselves into REITs and thereafter need never pay tax again.

Take Hammerson, which owns Birmingham's Bullring, among other big commercial holdings. Last week it became Britain's first company to announce that it planned to become a REIT. In exchange for a one-off charge of 2% of assets (which last year would have amounted to £83m) and the promise to pay most of its future profit to shareholders, Hammerson will erase potential tax liabilities of about £365m and free itself from future impositions. Its shares gained 1.7% on May 4th on the announcement, taking the increase for the year to 17.5%. Most of Britain's remaining listed property companies are likely to follow suit. That would move about £60 billion-worth of property into REITs, adding to the $700 billion (£375 billion) that bankers at UBS estimate is already sitting in similar structures around the world.

Under current rules, the earnings of all companies are potentially taxed twice: once when the firm pays corporate income tax and again when shareholders pay personal income tax on the dividends they receive. The government claims that huge benefits will flow from taxing property companies more leniently than other firms. It argues that REITs will bring liquidity to the market, which, together with planning reforms, will help to foster residential development and ease a shortage that has fuelled a boom in prices for more than a decade. They will encourage retail investors to add to their property holdings by giving them more choice and diversity. And property firms will reduce their debts, making the whole system more stable.

The Treasury has a fair case on some of these points. Retail investors are encouraged now to make direct bets on buy-to-let homes because any profits from them are taxed just once; they would do better to spread the risk. Property companies have to pay capital-gains tax if they sell properties that have increased in price and so are likely to hold on to them. And to depress taxable income, firms have been taking on deductible debt, says Simon Melliss, the finance director at Hammerson.

But REITs may in fact do little to encourage investment in new housing stock. Only companies that are listed on a recognised stock exchange can turn themselves into REITs, and few of them own residential housing because yields are appallingly low, says Peter Damesick, head of research at CB Richard Ellis, a property consultancy. Nor does it make much sense to encourage retail investors to buy property of any sort now that prices have boomed and yields are at record lows, according to IPD, a property-research company.

Such considerations lead some to suggest that REITs have come about for less high-faluting reasons. Property firms fear competing with tax-free entities proliferating offshore (ownership of some £3 billion-worth of property has shifted to Guernsey alone since 1998). The government fears that British property expertise will emigrate and, even more, further erosion of its tax revenues. “Part of the incentive is to bring some of that money back onshore,” says John Challoner, of Norton Rose, a law firm. Chance would be a fine thing.

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Bagehot

Prepared to wound but not to strike

May 11th 2006
From The Economist print edition

Gordon Brown may huff and puff, but Tony Blair will not be booted from office like Margaret Thatcher

THE notion that history is repeating itself is always hard to resist. It was another ghastly week for Tony Blair, with widespread rumours of a plot by Labour MPs to force him into producing a timetable for the handover of power. An emboldened Gordon Brown could not resist resurrecting the memory of Margaret Thatcher's tearful exit from Downing Street. “Remember”, said Mr Brown, “when Mrs Thatcher left, it was unstable, it was disorderly and it was undignified.” Nobody could mistake the chancellor's threat to the prime minister.

There are indeed some parallels with 1990. Mr Blair has won three successive elections and established something like hegemonic dominance for his party, as Mrs Thatcher did earlier. Like her, however, he has come to be seen by his party as an electoral liability, with disastrous local government elections a warning of worse to come. He is faced, as she was, with an opposition that is rediscovering competence and sense. Both made enemies during their long years in office and engendered hostile coalitions made up of the dispossessed, the passed over, the awkward and the bored. Like Margaret Thatcher, Mr Blair is now accused of being out of touch and, by arrogantly clinging to office, of denying his party the opportunity to renew its appeal to the electorate.

But there, the parallels end. To begin with, Labour MPs have far less to be worried about now than the Tories did in 1990. It is only a year since they won a comfortable, if reduced, parliamentary majority. For most of the past 12 months, the government has been level-pegging in the opinion polls with the Tories, despite the latter's new media-friendly leader, David Cameron. Only this

week, after a really awful sequence of embarrassments and mistakes, has Labour's rating dipped to a point that justifies jitteriness. In 1990, in contrast, the Conservatives had at most 18 months to go until the next election and had been behind in the polls for the previous 18 months by up to 24 points.

The reasons for the Tory party's unpopularity were also more deep-seated than anything Labour has to worry about today. The economy was turning nasty. Interest rates had been raised to 15% in an effort to bring inflation under control. The full brunt of the recession to come had not yet hit the Tories' south-eastern heartland, but a vital part of the Thatcher coalition—the aspiring upper working and lower middle classes, who had been encouraged to take out mortgages and buy their own homes—was already reeling. There are signs from last week's council elections that the same voters who deserted the Tories then are turning on Mr Blair now, because of tax fatigue and growing scepticism about the promised improvements in public services. But they are grumpy rather than scared and angry.

Nor is there anything in the list of grievances against this government to compare with the sheer hatred felt for the poll tax—a policy with which Mrs Thatcher was inextricably and personally linked. Bloody riots in London, mass non-payment and a gut feeling across the country that the flat tax for local services was regressive and unjust convinced Conservative MPs that there was a straight choice between scrapping the tax and electoral meltdown. Mrs Thatcher's refusal even to consider retreating was seen by many MPs as a political death sentence. Some now suggest an analogy between the poll tax and the war in Iraq. But since last year's election, when Iraq was the dog that barked only briefly, the war's capacity to hurt Labour has ebbed.

A further difference between the Conservative government then and the Labour government now is that the former was bitterly divided over an important issue of principle—European monetary and political union—which had crippled relationships between Mrs Thatcher and some of her senior ministers. By comparison, the spats between Mr Blair and Mr Brown, although exhaustively chronicled, have more to do with competing ambitions than with the kind of policy differences that registers with voters. Apart from his difficulties with Mr Brown and the inevitable bruises left by reshuffles, Mr Blair is still quite liked by his senior colleagues—again, unlike Mrs Thatcher.

A risky business

But the critical differences between now and then are that Mr Blair has promised to go well before the next election and that Mr Brown has more to fear than Mr Blair from a disorderly transition. It was Mrs Thatcher's insistence that she would “go on and on and on” that settled her fate. Enough Tory MPs reckoned it was worth taking almost any risk to prevent that happening and, moreover, they had a less cumbersome way of triggering a leadership contest than Labour does. Even Labour MPs who can't wait to see the back of the prime minister know with reasonable certainty, after the events of this week, that they have only 18 months at most to wait. The majority of them are not so self-destructive that they can't see a deeply unattractive risk/reward ratio in forcing Mr Blair out.

Mr Brown also finds himself in an entirely different situation from Michael Heseltine, whose challenge brought down Mrs Thatcher. Mr Brown knows that he will soon have the top job. To get it a year earlier than otherwise might be nice, but not at the cost of unleashing the sort of fratricidal strife and recrimination that poisoned Tory politics for more than a decade. Mr Heseltine, on the other hand, had nothing to lose: toppling Mrs Thatcher was not just his only hope of becoming prime minister; it was his only hope of returning to front-line politics.

A large number of Labour MPs may wish that Mr Blair would pack his bags this weekend. If he is set upon celebrating his tenth anniversary in Downing Street a year from now, however, there is

not much they can do other than accept it with as good a grace as they can muster. And, for all his huffing and puffing, the same goes for Mr Brown.

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Cheer up

May 11th 2006
From The Economist print edition

Reuters

Poles and outsiders alike are too gloomy. Despite the country's fractious politics, its prospects are bright and its problems solvable, writes Edward Lucas

Get article background

WARSAW airport immediately strikes the visitor as oddly cramped for something that seems so modern. That is because travel, like so many other things in Poland, is booming. A new airport building opened in 1992, replacing the ghastly concrete slum built by the communist central planners who ran Poland until 1989. The new building was designed to handle an ambitious 3.5m passengers a year. Last year it handled 7m, and this summer a new $225m terminal will open, raising capacity to 10m. Other Polish airports too are expanding at a cracking pace. The one at Katowice had just 16 passengers in 1991. In 1995 it had 15,000 and last year 1m.

Poland has become modern and prosperous on a scale that some still find surprising. Warsaw bristles with skyscrapers, and most of Poland is online. At the airport, three wireless internet networks compete for travellers' laptops. Across the road is a Marriott hotel, bustling with young, middle-class Poles in-between flights and business meetings, fiddling with their BlackBerries and chatting on their mobile phones.

But foreign travel is not a pastime only for Poland's rich. In another part of the airport, a large concrete barn known as the “Etudia” terminal is packed with Poles going to and from work abroad. Some are in suits; for Polish companies, low-cost travel is a boon, enabling them to do business abroad much more cheaply. But many of these passengers are the sort of people that you would not find in the Marriott. The older and more tired-looking ones are probably heading abroad for casual jobs in agriculture, construction or domestic service. At least such work brings in more

money than similar drudgery at home.

The numbers working abroad are huge, even for a country with nearly 40m people. Since 2004, some 200,000 Poles have gone to Ireland, and probably over half a million to Britain. The main reason is that there are few jobs at home, especially for the young and the unskilled. General unemployment is running at 18% and youth unemployment at a shameful 40%, partly because of a demographic bulge, but also because Poland's hefty pension and social charges make its labour expensive. For a couple with two children, this tax “wedge” is 42%, the third-highest in the industrialised world. Only half the working-age population is active in the labour market (see chart 1).

Migration and unemployment are big topics in the Polish media, which are by far the best of any post-communist country. Three heavyweight dailies, a zingy tabloid and three serious colour newsweeklies are on sale at every news-stand. But some news-stands are better than others. The state-owned chain, Ruch, offers cluttered layout, dim lighting and languid, even snarling service. Its main competitor, Relay, is much more user-friendly. That is because its smiling staff are the owners and employees of tiny businesses that rent the premises from the owner of the brand and use family labour—teenage children, spouses and parents—to avoid the job-killing tax and social charges. The Polish business environment may be full of obstacles, but the country's entrepreneurs are amazingly good at circumventing them.

Travel from the airport is revealing too. Rich Poles are met in limos; slightly poorer ones collect their cars from the hotel car park; the unwary take overpriced taxis, having failed to find the regular sort on offer round the corner. The poorest travel in the draughty, slow, old, dirty and pickpocket-infested bus that grinds its way to the city centre.

The best bits of Poland are now indistinguishable from their counterparts anywhere else in the world; the worst bits, including public services such as transport, are egregiously bad. Politicians, so far, have done little to dent that. “The Polish emerging market works much better than the Polish emerging democracy,” says Grzegorz Kolodko, a former finance minister now based at one of Warsaw's top business schools.

As you inch into town, cast an eye on the concrete-panelled fences to right and left, and the vast tracts of former military land behind them. Those on the right have been sold off cheaply in murky circumstances under past governments: a good example of how bad public administration in the past has cheated the taxpayer, disillusioned voters and perhaps enriched crooks. On the left, behind a display of decaying tanks and rusty fighter planes, is the huge 60-hectare Zwirki site, centred on a shabby 1970s concrete conference building where the Warsaw Pact's generals once deliberated. That would be worth perhaps $100m if the government were to sell it simply as land. But the defence ministry is looking for a different, more lucrative sort of deal in which it would share in the profits from any development. That sort of deal would have been unthinkable when Poland's military property agency was run by bureaucrats. But now the agency is headed by a forceful retired Anglo-Polish investment banker, Maciej Olex-Szczytowski, who has moved to Warsaw to work, pro bono, for the new government, to help it live up to its motto: “Cheap and efficient”.

Exchange rates
Polish zloty, May 1st 2006

$1=	3.06	£1=	5.60
€1=	3.86	¥100=	2.71

Open for business

“European quality, Polish prices, Czech VAT.” The sign captures Polish capitalism in a nutshell. Marek Glinkowski's doors and windows business is based in Poland, but as close to its customers in the Czech Republic as is physically possible, in the last building before the bridge over the river Olza that links the Polish city of Cieszyn with its suburb of Tesin in the Czech Republic. Mr Glinkowski's firm epitomises the way Polish businesses are now attacking the newly opened markets of neighbouring countries—which is one reason for the leap in Poland's exports from $61 billion in 2003 to $95 billion last year.

Until Poland joined the European Union in May 2004, Cieszyn, known in Habsburg days as “Little Vienna”, was a pretty but rather depressed town on Poland's periphery, isolated from the rest of the country by bad roads and from the rest of Europe by the border. Getting goods across the bridge was difficult because of complicated paperwork and unpredictable queues. Mr Glinkowski says his business, founded in August 2004, simply would not have been possible before entry into the EU. Thanks to Poland's big domestic market, doors and windows there are 10-15% cheaper than in the neighbouring Czech Republic. Mr Glinkowski now has a sales force of four based in the Czech Republic, and 12 Polish craftsmen who drive over the border to install the windows.

For small firms such as Mr Glinkowski's, Poland's entry into the EU has transformed the business environment. Instead of being isolated behind customs barriers, they can sell their wares anywhere. Mr Glinkowski's biggest problem now is Poland's own bureaucracy, particularly as regards taxes. The tax rates are not much higher than those of its post-communist neighbours, but their administration is hugely more bureaucratic. Whereas the Czech tax authorities deal with his value-added tax in just 60 days, in Poland getting VAT refunded on exports takes around six months. And tax is only one of myriad administrative problems.

These are not just the usual entrepreneur's whinges. In the World Bank's latest comparison of the business environment in different countries, Poland comes 54th, behind such places as Kuwait, Tonga and Armenia. It is beaten by all its post-communist competitors in central Europe, except stodgy Slovenia. The cost of setting up a firm, for example, equals 22% of GDP per person, against an average of 13% in the post-communist region as a whole. In Poland an everyday business project—building a warehouse—involves 25 bureaucratic procedures and takes 322 days, compared with 21 procedures taking 252 days elsewhere in the region (and a lightning 70 days in America).

A half-hour drive to the north it is the same story, of success and frustration, but on a larger scale. Mokate, a privately held company with 1,000 employees and sales of 300m zloty, is Poland's best-known producer of prepared drinks. Some are strikingly, even piratically, similar to

international brands of coffee; others are inventive to the point of oddness. The main product line is foil-packed cappuccino powder (flavours include vanilla and almond). Then there are teabags, regular, flavoured and even one spiked with a patented form of powdered alcohol to produce a mulled wine of sorts. Post-communist consumers are lively experimenters.

Mokate is a third-generation family firm. When its pre-war restaurants and shops were nationalised under communism, the Mokrysz family started up a private building-supplies firm, which survived even though the company claims it suffered from “persecution”. Certainly Mokate has done remarkably well since 1990, increasing its sales more than fiftyfold in 15 years after moving from cement in sacks to coffee-creamer in sachets. EU membership has greatly boosted its exports and the firm now sells to 55 countries.

Whereas Mr Glinkowski's success is based on a low-cost, low-tech product, Mokate's edge is in high technology and know-how. Its ultra-modern powder tower rises like a skyscraper over a gleaming white R&D facility, looking slightly out of place in the impoverished countryside around it, where a decrepit coal mine, now closed, used to be the main employer. Food scientists produce a stream of new consumer products.

But even though the ingredients of the two firms' success are different, Mokate's spokesman, Jerzy Chrystowski, is just as frustrated with the government as is Mr Glinkowski. “We just want the rules to stay the same,” he moans. “They are always changing: VAT, corporation tax, excise duty. One day all our vendors, even tiny roadside stalls, had to buy cash registers. Now they are told it's not necessary after all. And everything is overformalised and slow. The procedures are too rigid.”

That is the big challenge facing Poland, and the central subject of this survey. The country's private sector is increasingly able to compete with the rest of the world, whereas the public sector, wasteful, expensive and bloody-minded, is not. That is one reason why up to a million Poles are now working abroad. But this migration, symptomatic of Poland's problems, also holds the key to their solution.

Readers may comment on this survey at: www.edwardlucas.blogspot.com

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The accidental government

May 11th 2006
From The Economist print edition

Poland's present rulers are very different from all their predecessors

Get article background

IF YOU listen to the chatter of the Warsaw media elite, you might think that Poland's centre-right government, in office as a minority administration since last November and as a majority coalition since last week, was the worst the country had ever seen. That is a demanding standard: since the collapse of communism, Poland has had strong governments and honest governments, but never both.

AP

The Lech and Jaroslaw show

Polish political parties lack the deep roots and mass memberships of their western European counterparts. They are fluid coalitions with blurred profiles. Confusingly, the ex-communists are now the most ardent capitalists and the ex-dissidents often sound authoritarian. A new generation of bright, honest, ideas-driven politicians is coming along, but as yet few of them are in power.

Although the communists were almost obliterated in the 1989 elections, their successor party has held power for all but 30-odd months since then, either as part of a coalition or in the form of Alexander Kwasniewski, the communist-era sports chief who served as president from 1995 until last year. But by last autumn the ex-communists' lingering grip on power had been destroyed by scandals. In the September elections to the 460-member lower house of parliament, the *Sejm*, the Democratic Left Alliance lost 161 seats; its share of the vote fell to just 11.3%.

However, the new government led by the centre-right Law and Justice party, now in unwieldy alliance with two populist parties, Self-Defence and the League of Polish Families, has also

provoked plenty of criticism. Law and Justice is full of ex-dissidents, tetchy, righteous and unpredictable. The normally level-headed Wojciech Olejniczak, who leads the ex-communist party, compares Law and Justice to the regime of Alyaksandr Lukashenka in neighbouring Belarus. Donald Tusk, the leader of the main opposition Civic Platform, says the government is trying to “seize absolute power”.

That does not seem to bother Poland's new bosses. Law and Justice, and particularly its populist allies, delight in picking fights with gays, feminists, secularists, liberals, the media, ex-communists, uppity foreigners (especially in Brussels) and anyone else who crosses their path. The new leadership is avowedly Catholic: most senior figures have crucifixes in their office and appear frequently on Radio Maryja, an ultra-Catholic station much disliked by more mainstream members of the church hierarchy, not least for its anti-Semitism.

The man everybody likes to hate most is the leader of the Law and Justice party, Jaroslaw Kaczynski. If his twin brother, Lech, had not won the presidential election, the party's victory in the parliamentary election would have made Jaroslaw the prime minister. But he reckoned that it might look odd for Poland's two top jobs to be held by identical twins.

So now Lech occupies the presidential palace and his brother Jaroslaw sits in the *Sejm*, keeping a beady eye on the government. When he disapproves of a draft law, he produces his own. The government usually gets the message. There is not much discussion at cabinet meetings. “Instructions come out of a black box,” says one participant. The Kaczynski brothers are in the box. Most ministers are outside it. Top appointments seem to be Jaroslaw Kaczynski's responsibility too. When the treasury minister (responsible for privatisation) resigned, the prime minister, Kazimierz Marcinkiewicz, wanted a liberal-minded cross-party replacement. Instead he got a hardline economic nationalist.

The party chief makes frequent, vehement interventions in both parliament and the media. He has denounced the head of the central bank, Leszek Balcerowicz, demanding an investigation into his record, and is setting up a powerful new body to oversee the banking system. That has shocked those who see Mr Balcerowicz as a heroic figure in the country's recent economic history. As finance minister in the early 1990s, he pioneered the monetary stringency and free prices that, his fans say, kick-started Polish capitalism. The central bank is a bastion of economic orthodoxy and has run a tight monetary policy to make up for what it sees as the spendthrift habits of the politicians.

The media have also incurred Jaroslaw Kaczynski's displeasure. “There are no free media in Poland,” he controversially declared earlier this year. He wanted a special commission to examine links between journalists and the security services. His main target is what he calls the “lying elite” or the “establishment”—a mixture of shady businesspeople, semi-retired spies and their hangers-on in the media.

Weird and wonderful

His commitment to Poland's membership of the European Union has sometimes been questioned, and the new government's handling of foreign affairs has looked inept. Law and Justice, and particularly the Kaczynski brothers, hold ardently pro-American views, matched by loathing of both Russia and Germany. This goes back quite a while. In the early 1990s, after a lengthy lecture by Jaroslaw Kaczynski on German wickedness, an exasperated Helmut Kohl, then Germany's chancellor, ordered him out of his office in Bonn and told an aide: “Don't let that man within gunshot of this building again.” Mr Kaczynski says he was surprised at his treatment: he had just been “speaking plainly”.

Things do not seem to have changed much, judging by a recent interview given by Lech Kaczynski to one of France's best-known television journalists, Vincent Hervouët, at the Polish embassy in Paris. To start with, Mr Kaczynski kept his interviewer waiting for four hours. When he did surface, he took offence at Mr Hervouët's failure to rise from his seat, and answered the questions while staring at his shoes. Next, Mr Hervouët snapped at an aide who tried to hurry the interview along—at which point Mr Kaczynski ejected his guests from what he said was Polish territory. The interview, mercifully, was not broadcast.

Oddly, such behaviour goes down well with some Poles, who like to see their leaders putting snooty foreigners in their place. But outsiders are less charmed. Diplomats and foreign business representatives in Warsaw trade stories of spectacular scheduling mishaps and outbreaks of pomposity over protocol. A dinner for foreign ambassadors is cancelled at short notice, rescheduled, cancelled again at even shorter notice and suddenly switched to a different venue. Senior figures promise to appear but never show up; requests for meetings go unanswered. “There's a limit to the number of times I can remind them that they are meant to be visiting us soon,” says a sympathetic but exasperated ambassador to Warsaw of another post-communist country. Another foreigner, with many years' experience of dealing with Poland, is blunter: “They are amazingly arrogant and amazingly ignorant.”

Some of this does no real harm: a diplomatic dinner here or there or nowhere is not the end of the world. But sometimes lack of co-operation costs real money. Poland's agriculture minister, Krzysztof Jurgiel, simply refused to take part in a recent round of European negotiations over sugar beet. When he learnt what his European colleagues had decided in his absence, he tried to invoke his country's veto, only to discover that the decision was subject to majority voting. Many of the civil servants who would have known better have been booted out.

All this confusion reflects a big difference between the current and the previous political elite. Poland's present rulers are remarkably insular. Only two senior ministers speak fluent English. A top government adviser admits: “These people are mostly not very interested in foreign affairs. They don't speak languages, they don't travel abroad. They just don't care.”

In fact, they do care about some things. For instance, the government had an ambitious plan for European energy security: an “energy NATO” in which each member country would guarantee the energy supplies of the others in an emergency. But the idea was poorly launched and got nowhere: a pity, because Poland's dependence on Russian energy, particularly gas, is a big long-term problem.

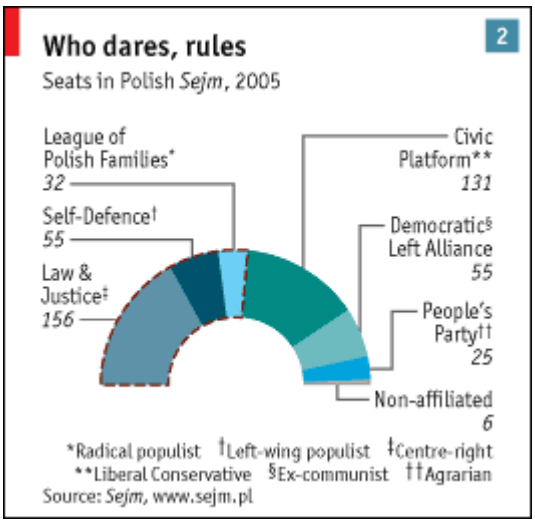
According to the critics, the government is either sinister or pathetic. It understands nothing of foreign policy or economics, is obsessed with the grudges of the past and pursues only its own bizarre, confrontational agenda. But have the critics got it right?

Who would have thought it?

In trying to understand what is going on, it is worth recalling that nobody, least of all its own members, expected this government to gain power last autumn. In the run-up to the elections, the polls suggested that the Kaczynskis' Law and Justice party would be the minority partner in a coalition government led by the more liberal-minded conservatives of Civic Platform. This is a party that oozes familiarity with both foreign affairs and economics and appeals to the winners of the post-communist era: the Europhile, pro-business middle classes who think that the country is on the right course and just needs tweaking. By contrast, Law and Justice's populism attracts the poor but patriotic who feel that the past 15 years have been grubby, harsh and disappointing.

That promised the best possible outcome: Poland's first strong, sensible government in its post-

communist history. But post-election talks between the two parties ultimately failed. Law and Justice governed first on its own, and now with populist parties of right and left.



One reason for the controversy over Law and Justice may be that the party has got some bad people rattled. Polish politics is dirty, and Jaroslaw Kaczynski and his government are, for the first time in the country's democratic history, making a real effort to clean it up. For all the criticism levelled against the government, there is no evidence of any personal greed or corruption on the part of Law and Justice. “These people are living in the same grotty flats with the same grotty wives and drive the same grotty cars as they were 15 years ago,” says one acute observer of Polish politics. “Compare that with the mansions, Mercedes and mistresses that their political opponents manage to afford on their official salaries.”

Raw honesty is a refreshing change in Polish politics; and it is arguable that neither Jaroslaw Kaczynski nor his government deserve the ridicule heaped on them. For a start, Poland is a strongly Roman Catholic country, where polls show clear support for socially conservative values. Regarding homosexuality, abortion and euthanasia as sinful may strike liberal-minded city-dwellers (and many foreigners) as wrong-headed. But it is not scandalous in itself that conservative Catholic politicians should represent their voters' values. Despite its dire image abroad, the government is well liked at home.

In particular, Mr Marcinkiewicz is one of the most popular politicians the country has had for years. One of his government's big achievements, he thinks, is its progress on breaking with the sleaze and cronyism of the past. “We have been very tough on bad behaviour,” he says. The government's first treasury minister was fired soon after his appointment for a financial peccadillo that in former times would have attracted little notice.

The best illustration, though, was the government's response to a newspaper stunt. The daily tabloid *Fakt* telephoned the agriculture minister, Mr Jurgiel, with a message supposedly from a close friend, Father Tadeusz Rydzyk, the head of Radio Maryja, claiming that his car had broken down. Could the minister send his official car? Eager to oblige his influential media ally, Mr Jurgiel ordered his driver to pick up the stranded cleric. Waiting photographers gleefully took pictures of the official limousine on its abortive mission. Mr Marcinkiewicz (though himself close to Radio Maryja) publicly rebuked Mr Jurgiel and ordered him to pay compensation for misusing state property.

The biggest clouds over that squeaky-clean image come from the new coalition partners. Self-Defence has murky business and other connections; the League of Polish Families' youth wing is anti-Semitic and homophobic. The League's leader, Roman Giertych, is now a deputy prime minister with responsibility for education. Andrzej Lepper, the leader of Self-Defence, has also been made a deputy prime minister, with overall responsibility for agriculture and rural development. Though he now sounds more moderate, his past statements on economic policy and Europe have been outlandish.

Still, on some issues of substance, Law and Justice has had good reason to behave as it did. For example, Mr Balcerowicz, the embattled central-bank governor, appeared to be provoking a confrontation. Where the government has tripped up so far, it seems to have been mainly from inexperience rather than malevolence. The double act of Jaroslaw Kaczynski and Mr Marcinkiewicz arguably works quite well: one stirs things up and plays politics, the other calms them down so

that the business of government can go on.

The Kaczynskis' robust and sometimes ill-informed approach to European institutions is strikingly different from that of their ex-communist predecessors, who seemed intuitively to understand how things worked and how to make themselves look good in the eyes of powerful outsiders. Asked about EU competition policy, Jaroslaw Kaczynski makes a straightforward case for protectionism: “I would rather have the EU rules paying more attention to the situation of people who for 50 years didn't have a chance of normal development and should have some privileges now.”

But Mr Marcinkiewicz, in his only big international test so far, at the EU's summit in Brussels last December, proved a canny negotiator, winning Poland a deal worth about *euro*90 billion ($109 billion) over the next seven years. He is also making progress on reforming the remarkably incompetent way in which Poland spends that money. Polish foreign policy may be crudely cast, but it is not as mad as some make out.

The old enemy

Lastly, it is not surprising that Poland's new rulers are twitchy about the people who dominated the country's politics for so long. Jaroslaw Kaczynski uses the image of a bridge table, where the four players are businesspeople, spooks/bureaucrats, gangsters and politicians, all engaged in games against the public interest. That, at least in the mind of Mr Kaczynski and his advisers, is pretty much the way things are in Poland. He likes to talk of the *uklad*—a sinister, all-encompassing structure which has, in effect, stolen the country during the past 15 years. Where outsiders see the triumph of capitalism and democracy, Poland's current government sees a calamitous surrender to the former communists and their collaborators, and moral bankruptcy. What the communists lost in 1989, they have regained since. Every institution is contaminated: the judicial system, the civil service, the banks, the state-owned industries and particularly the intelligence services (see article). This government's job is to clean house.

Sometimes that mission justifies a bit of hyperbole. Mr Kaczynski's notorious remark about “no free media in Poland”, he says mildly, was an exaggeration to make a point. “If I had said that some media are not always fully free, nobody would have noticed. But the mass media are very one-sided.” He brushes off the suggestion that Poland should be proud of its press. “It is the product of a crippled economy and a crippled democracy.”

Critics say that Mr Kaczynski and his party colleagues may believe in democracy and tolerance in theory, but in practice they are deeply, perhaps even obsessively, convinced of their own rightness and the wickedness of others. That is a big disadvantage if you are trying to build strong, clean, independent institutions. There is certainly plenty of tidying up to do in Poland's public administration; the danger is that dysfunctional old institutions will give way to dysfunctional new ones as sleazy old communists are replaced by new zealots and coalition kooks.

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Spy games

May 11th 2006
From The Economist print edition

Old habits die hard

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IMAGINE that different factions in America's Federal Bureau of Investigation made a habit of bugging politicians and leaking material to journalists; that America's military intelligence agency was not under effective Pentagon control, and was engaged in large-scale business activities, both legal and illegal; and that former senior officers held influential positions in many of America's big companies and public organisations. Imagine, further, that several dozen officers currently serving in the organisation had been trained by Soviet military intelligence and were still in regular contact with their former trainers.

That, broadly, was the situation confronting Poland's new government when it took office late last year. It helps to explain why it has made cleaning up the country's intelligence and security services such a priority. In particular, liquidating the WSI, the military intelligence agency and one of Poland's last outposts of unreformed communist-era bureaucracy, was a central theme of last year's election campaign.

AP

Sikorski was spied on for too long

One of the politicians keenest on sorting out the WSI was Radek Sikorski, who had already served in two post-communist governments. The skeleton in his cupboard, he feared, was that while studying at Oxford in the early 1980s, as a political refugee from communist Poland, he had been a member of the Bullingdon club, a student fraternity notorious for its wild parties. He fully expected some of his youthful follies to rebound on him during the election campaign. But there was not even a rumble. Within days of Mr Sikorski becoming defence minister, he was negotiating the resignation of the WSI's director and other top brass.

A few months later, he was able to see his own file. This showed that the WSI's communist-era predecessor had indeed been spying on him at Oxford (though the champions of proletarian internationalism had failed to penetrate the aristocratic Bullingdon). That was to be expected. What was more alarming was that the WSI had also kept him under intensive surveillance after the collapse of communism—and even after his brief stint as deputy defence minister in 1991-92.

Mr Sikorski (who is married to a former correspondent for this newspaper) has started to send all the WSI's Soviet-trained officers into early retirement. All remaining staff will have to undergo rigorous scrutiny. The organisation will be divided into conventional intelligence and counter-intelligence units. The new boss will be a civilian, not a soldier, and new recruits will include civilians too.

Both new services will have plenty to do, not least keeping up to date with the military developments in Belarus and Russia. Poland's Western allies already value their co-operation with the country's foreign intelligence service, the AW. The military branch should enjoy similar trust after its clean-up. But “there is still a huge threat to security from these people because they are rich and powerful,” says Zbigniew Wasserman, the government's intelligence co-ordinator.

There is another danger: that as one monster is slain, a new one may arise. Although Mr Sikorski insisted on keeping his intelligence service inside his ministry, Mr Wasserman wanted all the reformed services to report to him. Some fear that if Mr Wasserman did get his way over creating a single ministry of state security, the vital Chinese wall between politicians and spooks would crumble further. That is worth worrying about because the process is already under way. And however conscientious the present government may be in keeping the spies away from political opponents, its successors might prove less fastidious.

Mr Wasserman, a charismatic former prosecutor, brushes such worries aside. “In the light of the threats, we need full co-ordination and full control,” he says. Not everyone will be reassured by that.

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So much to do

May 11th 2006
From The Economist print edition

From the economy to the legal system, a lot needs to be put right

Get article background

SO WHERE does the new administration go from here? Provided that external conditions remain favourable, things could still turn out well, with the government settling in and controversy dying down. But there are dangers. One is Law and Justice's insatiable appetite for a scrap, which might lead to a serious conflict with the European Union, or a jealous putsch against Mr Marcinkiewicz.

Another danger is that the government's remarkable lack of co-ordination might get in the way of reform. A few weeks ago Mr Olex-Szczytowski and his colleagues at the defence ministry were surprised to hear Mr Marcinkiewicz announce the abolition of the military property agency on television. That plan, drafted by a junior official, had reached the prime minister's desk without brushing reality. No sooner was the plan announced than it was forgotten.

But the greatest danger is of an external economic shock. If the government were to alarm foreign investors (for example by ruling out joining the euro, rather than just making sceptical noises), that could prompt a collapse in the stockmarket and the currency. The resulting economic slowdown, in turn, would restrict government spending, making it impossible to oil the political wheels.

For the government's critics, such an economic disaster would be the best medicine possible. A run on the zloty, soaring inflation and sagging growth (preferably all three) would be an appropriate penalty for what they see as the innumerate populism of the Kaczynskis and their allies.

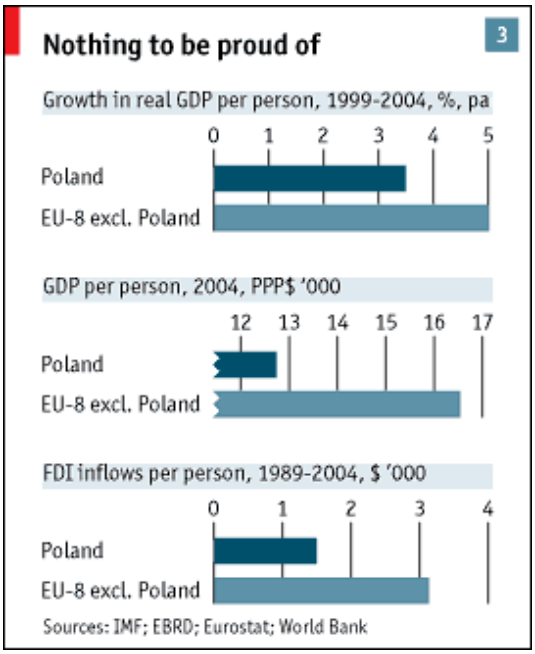
But for the moment none of this seems to be happening. The central government budget deficit in 2005 was 27.5 billion zloty, a mere 2.8% of GDP. The 2006 budget (inherited from the previous government and only slightly tweaked since) provides for just a small rise in the deficit, to 30.6 billion zloty. Growth in 2005 was only 3.2%, but increased to an estimated 5.2% at an annual rate in the first quarter of this year and is expected to reach 4.4% for the year as a whole. Average inflation in 2005 was 2.2%; real wages rose by just 1.7%.

Most importantly, exports are booming. The Economist Intelligence Unit, a sister organisation of *The Economist*, thinks that they will keep growing by more than 8% annually for at least the next four years. True, imports are rising sharply too, but that includes lots of capital goods needed for modernising the economy. The current-account deficit is a very manageable $4.8 billion, or 1.6% of GDP. Net foreign direct investment last year reached $7.5 billion, roughly what you would expect for a post-communist country of Poland's size.

All too average

These numbers are encouraging, but they are not great. Many of Poland's neighbours are doing better. The Czech Republic notched up annual growth of 6.9% at the end of 2005. Lithuania, on which the Poles tend to look down, reached 8.8% and Estonia 11.1%. Admittedly small countries may find it easier to put their economies right, and Poland is getting richer quicker than other big post-communist countries such as Romania and Ukraine that have remained outside the EU. But then Poland is much closer to the rich part of Europe, and its workers are better educated. The fairest comparison is with the average for the eight post-communist countries that have joined the EU (see chart 3). Poland scores poorly here, as it does on a wider comparison with mostly much poorer countries across the region (see chart 4).

This is particularly true for employment. In its advice to the new government, the International Monetary Fund said that the labour market needed urgent attention. It called on the government to take advantage of “unusually favourable” conditions to deal with fiscal and structural weaknesses and raise private investment and job creation.


Nothing to be proud of
3
Growth in real GDP per person, 1999-2004, %, pa
0 1 2 3 4 5
Poland
EU-8 excl. Poland
GDP per person, 2004, PPP$ '000
12 13 14 15 16 17
Poland
EU-8 excl. Poland
FDI inflows per person, 1989-2004, $ '000
0 1 2 3 4
Poland
EU-8 excl. Poland
Sources: IMF; EBRD; Eurostat; World Bank

Easier said than done. Mr Marcinkiewicz's office is strikingly underpowered, both in people and in clout. The best advertisement for the government are the ministries that are quietly getting on with piecemeal reform, particularly things that do not require legislation. “We are the government, so we don't have much to do with politics,” says a senior prime ministerial adviser, in all seriousness.

But not every problem can be tackled that way. Privatisation, for example, is not being pursued with sufficient vigour. Electricity privatisation has been stymied by pressure from the trade unions, and the petrochemical industry is off limits. The same is probably true for the post office and the railway infrastructure. But that still leaves plenty of opportunities elsewhere, not just for selling the minority stakes that the state still holds in scores of firms, but for disposing of wholly state-owned companies too. Pawel Szalamacha, the dynamic deputy privatisation minister, says that Ruch, the sleepy state-owned chain of newspaper kiosks, will be restructured and sold this summer. “It's a post-socialist corporate bureaucracy in the worst sense of the word,” he says. At the military property agency, Mr Olex-Szczytowski plans to raise more than 2 billion zloty by 2009 from selling surplus property, and to cut procurement costs by a tenth through centralised purchasing and online auctions.

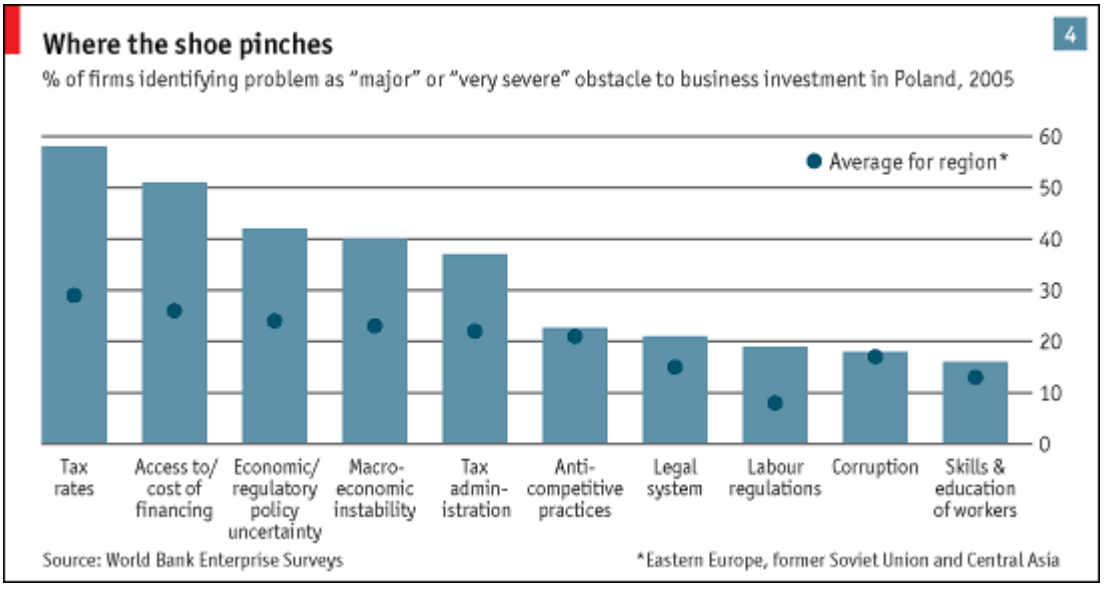
Tax reform is high on the list of the government's priorities. From 2009, all but the richest Poles will pay a flat-rate income tax of 18%. The government is also promising indexation of tax thresholds and speedy cuts in social charges to make labour cheaper. At a tax conference organised in Warsaw in March by the American Chambers of Commerce in central Europe, there was no shortage of complaints from the Polish-based companies. But Miroslaw Barszcz, the deputy finance minister in charge of taxation, was given an appreciative reception. A former tax partner at the Warsaw office of Baker & McKenzie, an international law firm, he batted back even the most technical questions, and then started handing out dollops of good news for companies: VAT returns, for example, would in future need to be filed only quarterly, not monthly. A tax-reform package at the end of March went even further, allowing most companies to file their corporate tax returns only once a year.

It's the law

Law and order is also receiving plenty of attention. The government is setting up a powerful new central anti-corruption office with hundreds of new staff, which has pitched the justice minister, Zbigniew Ziobro, into a furious confrontation with the country's legal establishment. Critics say that the anti-corruption office will just create an extra bureaucratic layer in the already top-heavy criminal-justice system. With half a dozen agencies already entitled to bug potential wrongdoers, why does Poland need another one?

“Current structures are ineffective, so we must create a new one,” says Mr Marcinkiewicz. “We need lawyers and economists working there, and above all people not connected with communist Poland.” The main concern for Mr Ziobro, an energetic 35-year-old lawyer, is to speed up and clean up the justice system. Getting a court judgment against a defaulting debtor, for example, on average takes 850 days. “It should take 30 days, not nearly three years,” says Mr Ziobro. He wants courts to work round the clock to deal with hooligans, and to raise productivity by computerising paperwork. By the end of the year every judge will have a clerk to deal with timetabling, witness summonses and research. Mr Ziobro thinks that “judges should spend their time on adjudication, not bureaucracy.”

Poland has 5,000 advocates and 20,000 solicitors, but 12m cases pending. The answer is more lawyers. The biggest reform has been to break the profession's cartel on admission. Mr Ziobro reckons that 90% of Polish legal professionals are the children or grandchildren of lawyers. But now anyone with a law degree and three years of related experience can take the exams. He is also increasing the numbers of examining magistrates by half and reforming the ineffective bailiff system.



It is hard to overstate the importance of all this. For example, the constipated legal system is a big brake on bank lending to small business, which is unusually low in Poland. If collecting bad debts is slow and costly, only the biggest and best customers are likely to get loans.

The danger is that by attacking on all fronts, even a minister as energetic as Mr Ziobro will lose focus. He burns with enthusiasm to clean up corruption in the police, increase salaries and put more officers on the beat; he wants to tackle organised crime properly; to crack down on bribe-taking; to make the bankruptcy procedures faster and simpler; to encourage dispute resolution outside the courtroom; and, overall, “not just to catch up on the European level, but exceed it”. All

that would be a tall order even with the support of the legal profession. Given its active resistance, he will find it harder still.

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A country to run from

May 11th 2006
From The Economist print edition

But only for a while

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TURN off the main road anywhere in Poland, drive for a bit, and you will find yourself in a different country. The roads become worse, sometimes abominably so. The one-storey log cabins and horse-drawn carts of Poland's rural past make an appearance. More commonly, you will see roofless concrete shells, the ruins of communist-era collective farms or tractor stations. Nearly 15m people, over a third of Poland's population, live in the countryside. Some 5m of them work on 2.5m farms. Life is dull and bleak. Mains sewerage is a rarity, as are reliable public services of any kind. There are few non-farming jobs. It is easy to see why people might want to leave.

Nienadowka is a village in Poland's dirt-poor south-east corner. Social life, says Roman Nowinski, a sardonic dairy farmer, revolves around going to church and talking to the neighbours. Of the 2,800 inhabitants, a tenth have already gone to work abroad since Poland's EU entry opened the doors to legal migration to Britain, Ireland and Sweden. “They laid on courses for us farmers to learn English,” recalls Mr Nowinski. “It was very handy.”

In some parts of Poland, EU membership has been a boon for ambitious farmers wanting new machinery to modernise and expand. But there is little sign of this in Nienadowka, where tiny plots are inconveniently scattered around the village. Mr Nowinski's annual subsidy for his 10.5 hectares (26 acres, large by local standards) is 4,500 zloty. He gets 0.63 zloty for each litre of milk, 15% less than before EU entry; if he produces more than his 16,000-litre annual quota, he is fined. “This isn't farming,” he says. “This is just existence.”

Taxi

See you later

But even in the boondocks, things are stirring. A few kilometres away is Smak-Eko, a small meat-processing plant but a big local employer with 150 workers. The co-founder, Eugeniusz Bernat, who returned to Poland after a spell in America, says EU money helped his firm meet new hygiene rules. He wants it to be a niche manufacturer of organic products, but does not expect it to be easy. “Look!” he fumes, brandishing a report on deregulation by the Adam Smith Centre, a Warsaw-based free-market think-tank. “No fewer than 40 state institutes with the right to inspect and check a business!”

The mayor of Sokolow Malopolski, the town that includes both Smak-Eko's plant and Nienadowka, is Andrzej Ozog. He was 26 when he was elected, the youngest mayor in Poland. Like many Poles, he regards national politics as a tiresome sideshow. “I belong to no party,” he says briskly. “I just want to know when we are going to have a state that is transparent, honest and efficient.” He is doing his bit by making it easier for citizens to deal with the town hall online: internet connections, he says, are more common than mains sewerage. He hopes EU money will fix the drains, and pay

for a sports centre too.

Unemployment in the region remains high, at well over 20%. And from the regional capital of Rzeszow, a bumpy hour away by road, it is just two-and-a-half hours by plane to London. Ryanair, an Irish low-cost carrier, started flights to Rzeszow and half a dozen other Polish regional centres in October last year. Most days, the plane is full—in both directions.

One regular passenger is Justyna Dudek, a 27-year-old single parent who is moving to England, at least for a year, maybe more. It is not just that she is dissatisfied with the net salary of 800 zloty a month she gets for teaching English to teenagers. She also finds Polish workplaces much less appealing than those she has tried in England, including a bar and a travel agency. “Employers treat you differently. Here you are no one; there you are someone.” Abroad, relations with colleagues are better, too: “Here, everyone is much more stressed: if people get a good offer, they cheat on their friends.”

Half her former pupils are working in England already, she says, “and the other half are planning to go.” One reason for the exodus is poor Polish universities. There are islands of excellence, such as Warsaw University's institute of computing science. But they sit in a sea of mediocrity: undemanding, riddled with cheating, overcrowded and complacent. Mr Marcinkiewicz says reforming them is a priority, but it is hard to see Polish universities becoming dynamic, open and globally competitive soon. Until they do, many students will head abroad.

That raises two big questions: what is the effect on Poland of so many of its most enterprising people leaving? And what can the country do to tempt them back?

Jacek Bachalski, a politician and educational entrepreneur, holds out his hand to illustrate a lasting memory of an early trip to Britain. “The immigration officer rubbed his fingers against mine to see if they were rough. He was trying to see if I was really a bricklayer, not an undergraduate.” In the 1980s, Mr Bachalski was one of the few lucky Poles allowed to go West. When communism collapsed, there was a new obstacle: Western countries toughened their visa policies. Plenty of Poles still went, but most of them had to work semi-legally. Pawel Kaczmarczyk of Warsaw University says that migrants in those days tended to be low-skilled workers from the provinces. For them, even a job in the black economy was better than staying home.

Since the late 1990s, migrants have become younger and better educated: half of all Poles under 24 have some sort of tertiary education. In countries that still restrict Polish access to their labour market, such as Germany, the typical migrant comes for a seasonal job in agriculture. In Britain, one of the countries that has fully opened its doors, most Poles find jobs in business administration.

“The way it works is like this,” says Ewa, a graphic designer. “You start off in a bar or restaurant. You get to know the customers and find out what they do. When you find one who has the kind of work that you like and can do, you make friends with them and try to get introduced to their boss. Then you persuade him to try you out for a week, even unpaid. And because you are Polish and have good skills and work hard, you will get a job. Maybe even your new friend's job,” she laughs.

The brain boomerang

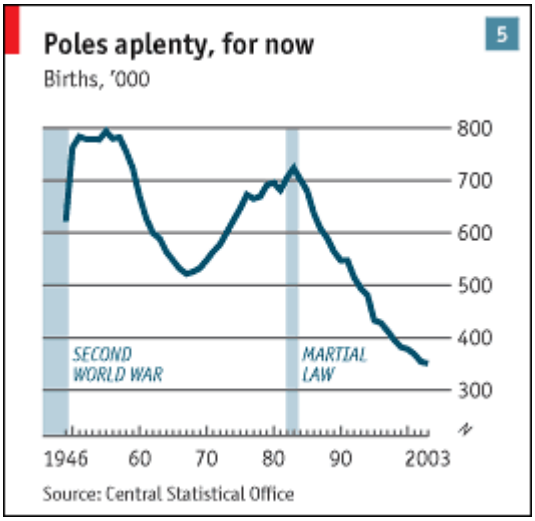
The benefits to western employers of getting well-educated and enthusiastic (if occasionally unscrupulous) Poles to work for them are clear. But what does it do to Poland? The big worry is that the outflow may drain the country of its best brains, especially in industries where the salary gap between east and west is large and the skills are readily transferable. The Polish media regularly feature stories about the effects of this brain drain, particularly on hospitals losing their

best doctors.

In reality, though, the communist health system provided too many doctors and hospitals, so there is some spare capacity. But it also seems that supply is keeping pace with demand: there are actually more doctors practising in Poland now than there were two years ago. On the whole, says Mr Kaczmarczyk, Poland has a “brain overflow” (an excess of well-qualified people), largely thanks to the demographic effect of martial law, imposed by the country's communist rulers in 1981-83. Perhaps out of boredom, perhaps as a sign of patriotic resistance, Poles started producing more babies (see chart 5). That generation is now entering the workplace.

Will the huge number of Poles who migrate in search of better jobs eventually return home? Many people initially plan to go abroad only for a short time to earn some extra money, but months may stretch into years, even a decade—though for this generation of Poles probably not much longer than that. They are not fleeing totalitarianism or foreign rule. Low-cost flights and an open labour market make it easy to go back and forth.

Work abroad is often less comfortable at first and, without the family, lonelier than at home, so having raised the money to buy a house or set up a business, people generally want to come back. The Sokolow police chief's cousin, Elzbieta, is working as a secretary in London to improve her English; she hopes to return home to run a property business.



Another advantage of working abroad is that it brings new skills, not only in foreign languages but in other know-how. Watching the way a Western workplace operates can be a life-changing education. “The first thing you notice is that everything is organised as it should be. There it is clear and here it is grey,” says Ms Dudek, the English teacher. That matters: Polish management is still often weak, especially in “soft” departments such as sales, marketing and personnel. “The Polish idea of being a boss is still sitting in a big office being rude to people,” says one long-time British observer of Polish business.

Migration also deepens the talent pool for employers in Poland. Guy Simmons, who runs a chain of hotels in eastern Europe for Domina, an Italian hotel company, says the number of Poles working in hotels in Britain and Ireland has made it far easier for him to hire staff who understand about service quality. “It's drained the market of some of its best talent, but when they return, which they almost always do, they bring all that experience back,” he says. Other hoteliers agree. Maryla Koralewska, director of human resources at central Warsaw's Marriott, says Poles who have worked abroad have better “contact skills”, knowing how to greet guests and recognise regular clients.

Mr Bachalski, who now runs a successful chain of private colleges, sees a deeper effect. Working in foreign companies, he says, helps Poles shed their instinctive distrust of authority. “We learn to respect good management, and we lose our complexes.” Ewa agrees. “Before I came to London, I thought I was a very special person from a very special country, and nobody would understand me. Now I think that I am like anybody else. It doesn't matter where you come from or who your friends are. What matters is how hard you work and how good you are.”

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Prickly to a fault

May 11th 2006
From The Economist print edition

It takes time to become normal

Get article background

POLAND is a country that foreigners criticise at their peril. Even the mildest mention of habitual unpunctuality, brusque telephone manners or bad roads can prompt a lengthy and emotional review of the outside world's insensitive and ignorant attitude to the country's tragic history.

Never forget that the country was divided up between three foreign powers (in the late 18th century, admittedly, but the wound remains livid). Remember that Polish heroism in blocking the Bolshevik advance into Europe, in the 1920 battle known as the "miracle of the Vistula", stopped communism marching westwards. Bear in mind Poland's betrayal by Britain and America at Yalta, and the failure to support the Warsaw uprising of 1944, when a Soviet army stood by as the Germans destroyed the capital city. And make allowances for the destruction of Poland's elite, leaving it without the middle class that helps stabilise and guide its luckier post-communist counterparts.

Alamy

Don't you dare call me prickly

Acknowledge also that Poland's tragic history is not just neglected, it is sometimes actively distorted. Careless references in the Western media (including, once, this paper) to Auschwitz as a "Polish concentration camp" (when of course it was built and run by Poland's hated Nazi occupants) provoke furious protests.

Bear in mind, moreover, that Russia, especially when allied with Germany, still menaces Polish security. Poles seethe with indignation about their two big neighbours' plans for an undersea gas pipeline that will bypass Poland, leaving it vulnerable to the Kremlin's whims.

Admit, too, that every country has its problems, many of them just as bad as Poland's. Doesn't Italy suffer from excessive bureaucracy (as well as wonky governments) and Greece from corruption? Surely France breaks EU rules and gets away with it? Doesn't Poland also have the right to be wrong? These are fair points—though Poland might do better trying to overtake western Europe rather than catching up with its worst bits.

What is rather odder is that praising Poland can go down badly too. A mild remark about the variety and excellence of the country's media or the growing strength of its private sector can be taken as being insensitive to poverty, unemployment and the inadequacy of public services, let alone the country's historical tragedies. A pampered Westerner cocooned in a comfortable hotel may prattle about progress—but it shows how little he knows about the real Poland.

Such prickliness remains, but it is diminishing. Living in Poland 20 years ago, your correspondent often found himself accosted by total strangers intent on having angry conversations on past wrongs such as Yalta. That still happens, but only rarely. For younger Poles, particularly those who have spent time abroad, history is water under the bridge, and the dark and steamy world of Polish exceptionalism, particularly the quasi-mystical notion of national martyrdom, is a fading relic of an unhappier age.

Yet the deeper problem remains. Wally Olins, an expert on branding who has worked on Poland's image at home and abroad, says Polish prickliness stems from “a tremendous lack of self-confidence”. Historical misfortunes, he says, have left Poles mistrustful of their ability to run their own affairs. That complicates the great task of modernising the country, and particularly of creating decent jobs. Mr Olins thinks Poland should try to follow Spain, another Catholic country on the edge of Europe that emerged from totalitarian rule and worked hard to achieve modernity, stability and prosperity. That is a fine aim—and for the first time in Poland's modern history, there is no real reason why it should not succeed.

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IKEA

Flat-pack accounting

May 11th 2006
From The Economist print edition

Forget about the Gates Foundation. The world's biggest charity owns IKEA—and is devoted to interior design

Rex Features

FEW tasks are more exasperating than trying to assemble flat-pack furniture from IKEA. But even that is simple compared with piecing together the accounts of the world's largest home-furnishing retailer. Much has been written about IKEA's remarkably effective retail formula. *The Economist* has investigated the group's no less astonishing finances.

What emerges is an outfit that ingeniously exploits the quirks of different jurisdictions to create a charity, dedicated to a somewhat banal cause, that is not only the world's richest foundation, but is at the moment also one of its least generous. The overall set-up of IKEA minimises tax and disclosure, handsomely rewards the founding Kamprad family and makes IKEA immune to a takeover. And if that seems too good to be true, it is: these arrangements are extremely hard to undo. The benefits from all this ingenuity come at the price of a huge constraint on the successors to Ingvar Kamprad, the store's founder (pictured above), to do with IKEA as they see fit.

Although IKEA is one of Sweden's best-known exports, it has not in a strict legal sense been Swedish since the early 1980s. The store has made its name by supplying Scandinavian designs at Asian prices. Unusually among retailers, it has managed its international expansion without stumbling. Indeed, its brand—which stands for clean, green and attractive design and value for money—is as potent today as it has been at any time in more than 50 years in business.

The parent for all IKEA companies—the operator of 207 of the 235 worldwide IKEA stores—is Ingka Holding, a private Dutch-registered company. Ingka Holding, in turn, belongs entirely to Stichting Ingka Foundation. This is a Dutch-registered, tax-exempt, non-profit-making legal entity,

which was given the shares of Mr Kamprad in 1982. *Stichtingen*, or foundations, are the most common form of not-for-profit organisation in the Netherlands; tens of thousands of them are registered.

Most Dutch *stichtingen* are tiny, but if Stichting Ingka Foundation were listed it would be one of the Netherlands' ten largest companies by market value. Its main asset is the Ingka Holding group, which is conservatively financed and highly profitable: post-tax profits were €1.4 billion ($1.7 billion)—an impressive margin of nearly 11% on sales of €12.8 billion—in the year to August 31st 2004, the latest year for which the group has filed accounts.

Valuing the Inkga Holding group is awkward, because IKEA has no direct competitors that operate globally. Shares in Target, a large, successful chain of stores in the United States that makes a fifth of its sales from home furnishings, are priced at 20 times the store's latest full-year earnings. Using that price/earnings ratio, the Ingka Holding group is worth €28 billion ($36 billion).

This is probably conservative, given IKEA's growth prospects. Sales—the only financial information that IKEA releases—for the year to August 31st 2005 were €14.8 billion, 15.6% up on a year earlier. And there is plenty of scope for more stores. Ingka Holding has only 26 outlets in America. By contrast, in Europe, a market of comparable size, it has over 160, accounting for more than 80% of its total turnover. In April IKEA opened its first store in Japan.

If Stichting Ingka Foundation has net worth of at least $36 billion it would be the world's wealthiest charity. Its value easily exceeds the $26.9 billion shown in the latest published accounts of the Bill & Melinda Gates Foundation, which is commonly awarded that accolade.

Measured by good works, however, the Gates Foundation wins hands down. It devotes most of its resources to curing the diseases of the world's poor. By contrast the Kamprad billions are dedicated to “innovation in the field of architectural and interior design”. The articles of association of Stichting Ingka Foundation, a public record in the Netherlands, state that this object cannot be amended. Even a Dutch court can make only minor changes to the *stichting*'s aims.

If Stichting Ingka Foundation has net worth of at least $36 billion it would be the world's wealthiest charity

The Kamprad foundations compare poorly with the Gates Foundation in other ways, too. The American charity operates transparently, publishing, for instance, details of every grant it makes. But Dutch foundations are very loosely regulated and are subject to little or no third-party oversight. They are not, for instance, legally obliged to publish their accounts.

Under its articles, Stichting Ingka Foundation channels its funds to Stichting IKEA Foundation, another Dutch-registered foundation with identical aims, and which actually doles out money for worthy interior-design ideas. But the second foundation does not publish any information either. So just how—or whether—Stichting Ingka Foundation has spent the €1.6 billion that it collected in dividends from Ingka Holding in 1998-2003 remains hidden from view.

IKEA says only that this money is used for charitable purposes and “for investing long-term in order to build a reserve for securing the IKEA group, in case of any future capital requirements.” IKEA adds that in the past two years donations have been concentrated on the Lund Institute of Technology in Sweden. The Lund Institute says it has recently received SKr12.5m ($1.7m) a year from Stichting Ikea (which also gave the institute a lump sum of SKr55m in the late 1990s). That is barely a rounding error in the foundation's assets. Clearly, the world of interior design is being tragically deprived, as the foundation devotes itself to building its own reserves in case IKEA needs capital.

Although Mr Kamprad has given up ownership of IKEA, the *stichting* means that his control over the group is absolutely secure. A five-person executive committee, chaired by Mr Kamprad, runs the foundation. This committee appoints the boards of Ingka Holding, approves any changes to the company's statutes, and has pre-emption rights on new share issues.

Mr Kamprad's wife and a Swiss lawyer have also been members of this committee, which takes most of its decisions by simple majority, since the foundation was set up. When one member of the committee quits or dies, the remaining four appoint his replacement. In other words, Mr Kamprad is able to exercise control of Ingka Holding as if he were still its owner. In theory, nothing can happen at IKEA without the committee's agreement.

That control is so tight that not even Mr Kamprad's heirs can loosen it after his death. The foundation's objects require it to “obtain and manage” shares in the Ingka Holding group. Other clauses of its articles require the foundation to manage its shareholding in a way to ensure “the continuity and growth” of the IKEA group. The shares can be sold only to another foundation with the same objects and executive committee, and the foundation can be dissolved only through insolvency.

Yet, though control over IKEA is locked up, the money is not. Mr Kamprad left a trapdoor for getting funds out of the business, even if its ownership and control cannot change. The IKEA trademark and concept is owned by Inter IKEA Systems, another private Dutch company, but not part of the Ingka Holding group. Its parent company is Inter IKEA Holding, registered in Luxembourg. This, in turn, belongs to an identically named company in the Netherlands Antilles, run by a trust company in Curaçao. Although the beneficial owners remain hidden from view—IKEA refuses to identify them—they are almost certain to be members of the Kamprad family.

Inter IKEA earns its money from the franchise agreements it has with each IKEA store. These are extremely lucrative: IKEA says that all franchisees pay 3% of sales. The Ingka Holding group, the company owned by the Kamprad foundation, is the biggest franchisee, with its 207 stores; other franchisees run the remaining 28 stores, which are mainly in the Middle East and Asia.

Clearly, the Kamprad family pays the same meticulous attention to tax avoidance as IKEA does to low prices in its stores

How much money does Inter IKEA Systems make? Its results are included in its parent company's accounts filed in Luxembourg. These show that in 2004 the Inter IKEA group collected €631m in franchise fees and made pre-tax profits of €225m. This profit is after deducting €590m of “other operating charges”.

Although IKEA would not explain these charges, because its policy is not to comment on the accounts of a private group of companies, Inter IKEA appears to make large payments to I.I. Holding, another Luxembourg-registered group that is almost certain to be controlled by the Kamprad family and which made a profit of €328m in 2004.

Together these companies had nearly €11.9 billion in cash and securities at the end of 2004, even after I.I. Holding paid out a dividend of nearly €800m during the year. Most of this money has undoubtedly come from the collection of franchise fees. In total, these two groups suffered tax bills of a mere €19m in 2004 on their combined profits of €553m. Clearly, the Kamprad family pays the same meticulous attention to tax avoidance as IKEA does to low prices in its stores.

The IKEA financial system of *stichtingen* and holding companies is extremely efficient. Even so, next time you wonder how anyone could have come up with the fiendish plans for a Hensvik storage unit or a Bjursta sideboard, spare a thought for the Kamprads' accountants.

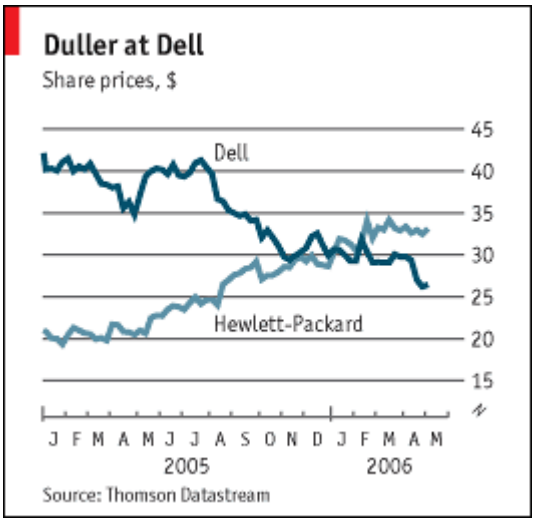
Computers

For whom the Dell tolls

May 11th 2006
From The Economist print edition

The world's biggest computer-maker is stumbling

EVER since Michael Dell started a company to sell computers from his University of Texas dormitory room in 1984 at the age of 19 with a mere $1,000, he has profited from big shifts in the technology industry. First it was the commoditisation of components; then the rise of the internet as a sales channel through which to reach customers. However, the very forces that the company relied on for success are now responsible for its troubles.



This week Dell said its quarterly earnings, due on May 18th, would fall at the low end of its estimates. Dell's share price immediately tumbled 6% to around $25, its lowest level in three years. It follows a year of other stumbles. Dell's market share has declined and its growth rate has fallen behind that of the industry as a whole.

Dell remains the largest PC vendor in the world, shipping 37m machines worldwide last year and commanding nearly 20% of the market (32% in America). Yet the firm, with a business model that was once the envy of the industry, has found that its chief advantages—the lack of a physical sales channel and the ability to squeeze suppliers—have become the chief sources of its woe.

This is because the market for computer equipment has radically changed, but Dell's business model has not adapted in response. In the past Dell used its extremely efficient supply chain, lack of sales staff, paltry inventory and direct link to customers to offer low prices that rivals could not seem to match. But that tactic no longer works. Over the past year, as Dell slashed prices, it failed to gain market share as it had hoped.

Dell says the problem is that it dropped prices too much. Kevin Rollins, the company's chief executive, says it now plans to “reinvigorate growth” by investing in customer support and improving quality. On the surface, Dell seems the victim of the law of large numbers. It has become so huge—last year its revenues were $56 billion—that its double-digit growth rates have proved to be unsustainable. But deeper, more threatening forces are also now at play.

The first is the resurgence of rivals, which have caught up with Dell's low-price model. By driving prices down, Dell has unintentionally cut costs for its rivals too. “The supply chain has become as standardised as the components—the money has been wrung out,” explains Nicholas Carr, the author of “Does IT Matter?: Information Technology and the Corrosion of Competitive Advantage”. Dell, by not working through retail outlets, is still more efficient, but the cost benefits that this once brought have been whittled away.

The second factor hurting Dell is that growth in the computer business is coming from the consumer market and emerging countries rather than the corporate market, in which Dell sells around 85% of its machines. Increasing sales to consumers is difficult for Dell because individuals tend to want to see and touch computers before buying them. They also like to be able to return the machine easily if it breaks. Dell's lack of retail presence, once ballyhooed as a benefit, has turned into a grave disadvantage. Likewise, sales in countries outside America are often based on the advice of sales staff, which places Dell's “direct-only” business model at a disadvantage.

The absence of physical stores has also stymied Dell's attempts to expand beyond PCs, which account for more than 60% of its sales, into consumer-electronics products such as televisions. And large companies are increasingly purchasing their computer equipment as part of a package of services from consultancies to address specific business problems, says Matt Eastwood of IDC, a research firm. Dell has tried to develop a services division to remedy this, but it has nothing like the clout of rivals such as HP and IBM.

A third problem facing Dell is its exclusive use of Intel chips rather than lower-priced (and in some cases better-performing) ones made by Intel's sworn rivals, AMD. This arrangement lets Dell buy chips inexpensively and benefit from Intel's generous co-marketing programmes. But it has started to harm Dell's sales for higher-margin computer servers. In March Dell acquired Alienware, a maker of high-end gaming PCs based on AMD chips. That could represent a long-awaited first step away from its Intel-only strategy.

Taken together, the changes in how computers are made and sold no longer favour Dell's business model, explains Ben Reitzes, an analyst at UBS, an investment bank. As a result, he believes Dell's best days are behind it. The commercial environment now benefits HP, with its established sales channel, large and well regarded services division and efficient supply chain—a dramatic reversal of fortune, since the firm's dependence on sales teams and retail outlets had only recently seemed hopelessly anachronistic. In the past year HP's market share increased from 13.8% to 14.9% according to Gartner, a research firm, while Dell's shrank slightly, the first time this has happened since it became one of the chief PC vendors a decade ago. But in the cut-throat computer business, success never lasts too long.

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Video games

Everything to play for

May 11th 2006
From The Economist print edition

Sony, long the leader in video gaming, is now starting to look like a follower

AP

THIS week, after much speculation, Sony finally announced the launch dates and the prices for its forthcoming PlayStation 3 games console. Just as industry rumours correctly predicted a delay to its launch, from May to November, predictions that the PS3 would be expensive also proved to be accurate. It will be available in two versions, priced at $499 and $599 in America, €499 ($640) and €599 in Europe, and starting at ¥59,800 ($540) in Japan. This makes the PS3 considerably more pricey than its two rivals, Microsoft's Xbox 360, which went on sale last year, and Nintendo's Wii (formerly known by its codename of Revolution), which will be launched later this year. Indeed, if Microsoft cuts the price of the Xbox 360 as expected when the PS3 launches, Sony's console could cost as much as its two rivals combined.

While the high price was not a surprise, Sony's announcement that it would include motion sensors in the PS3's controller certainly was. That is because it seems to have borrowed the idea from Nintendo, which has positioned the Wii as a console that will appeal to non-gamers, chiefly through its innovative, wand-like controller, which it showed off this week. (The announcements took place at E3, a big industry conference in Los Angeles.) Meanwhile, Sony's online service for the PS3, which will link gamers and allow them to download extra content, bears a close resemblance to Microsoft's successful Xbox Live service. Having been the industry leader for many years, Sony suddenly looks like a follower. Sony will also have to catch up with Microsoft in sales: by the time the PS3 launches, the Xbox 360 will have been available for over a year. Already, Xbox 360 sales are approaching 5m, and Microsoft's Bill Gates predicted at E3 that his firm would have a lead of 10m units by November.

The stakes are high for Sony: it is banking on the success of the PS3 not just to maintain its dominance in video gaming, but also to boost the fortunes of its Blu-ray technology, one of two rivals vying to become the high-definition successor to the DVD. Each PS3 will contain a Blu-ray drive—hence its high price—so that each console sold will help to seed the market for Blu-ray. But this strategy will work only if the PS3 sells well. Sony hopes its existing customers will prove faithful to the PlayStation brand despite the price tag, thus ensuring victory for the PS3 and Blu-ray. But the lower prices and innovative features of the PS3's rivals could test their loyalty to the limit.

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Berkshire Hathaway and Iscar

Thank you, O Sage

May 11th 2006 | JERUSALEM
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Israel over-enthuses at Warren Buffett's latest deal

WHEN the world's most famous investor makes his first overseas acquisition in a small, strife-torn country that he has never visited, one might forgive that country's leaders a little glee. Warren Buffett's decision to spend $4 billion on 80% of Iscar, an Israeli cutting-tools firm, was “an amazing statement about the Israeli economy”, said Ehud Olmert, the new prime minister, whose cabinet had been sworn in only the day before. The chairman of Berkshire Hathaway, he added, “says things about us that we're afraid to say ourselves.” The deal “should boost both domestic and international investor confidence in Israel”, concurred Merrill Lynch, an investment bank.

In fact, the deal says a lot more about the two firms—and their bosses—than about Israel. True, the Israeli economy does look healthy, continuing the rebound that began in 2003. Growth was 5.2% last year, although it will be a little less this year. The $1 billion tax on the Iscar deal, 0.8% of GDP, could even push Israel's budget into surplus (although the decision to grant Berkshire Hathaway strategic-investor status, with tax breaks for ten years, could end up costing the treasury more than $1 billion in foregone taxes).

But Iscar is the antithesis of the aggressive, corner-cutting stereotype often associated with Israeli business. The country reeled last year from a money-laundering scandal at its biggest bank, Hapoalim, and revelations that several blue-chip companies, desperate to outsmart each other in the small, cut-throat Israeli market, were hacking into each other's systems using computer viruses.

Iscar, by contrast, has offices or agents in 52 countries, making it far from dependent on the Israeli economy. Its chairman, Eitan Wertheimer, said he felt Iscar was reaching its limits as an Israeli firm and needed the backing of a big name for its own plans to break into areas like the American car industry. It was he who approached Mr Buffett last year and he did it the way the Nebraska investment guru likes best, with a short, to-the-point letter.

And Iscar is just the kind of firm that the homespun Mr Buffett understands and has often bought in the past: one built from scratch by the application of simple principles and honest hard work. Mr Wertheimer's father, Stef, was expelled from school aged 14 and set up the firm in a shed in 1952; the younger man took over 30 years later and gradually increased revenues 20-fold. Mr Buffett liked Iscar's steady long-term growth, its international reach, its investment in people and its close-knit, no-nonsense management style.

Mr Buffett, who wants to reduce his firm's $42.9 billion cash pile, has not ruled out acquiring other Israeli firms, saying he was open to suggestions; but it is also quite clear that they are not something he pays much attention to. (When an Israeli business newspaper, *Globes*, interviewed him, it found that he appeared not to have heard of Teva, the world's biggest generic-drugsmaker and the biggest firm on the Israeli stockmarket).

A member of the Berkshire Hathaway group, CTB, announced this week that it was acquiring control in an unlisted Israeli firm, AgroLogic, though it would not say for how much. But Berkshire's subsidiaries tend to operate without Mr Buffett's meddling; and anyway such a deal is small change for him. His next big buy, he hinted at the annual shareholder meeting on May 6th, the day after the Iscar announcement, could lie in Europe or Japan, could be in utilities—he bought an American utility firm for $5.1 billion in March—and could be worth $15 billion.

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Silicon Valley

Déjà vu 2.0

May 11th 2006 | NEW YORK AND SAN FRANCISCO
From The Economist print edition

Confidence is soaring again, but where are the hot IPOs?

LIFE is good again in Silicon Valley and its downtown San Francisco extension around South Park, where the coffee shops buzz to the dreams of a new generation of internet entrepreneurs. Venture capital is abundant. And, unlike the first batch of dotcoms, firms in the age of "Web 2.0" frequently boast both actual revenues and a plausible-sounding route to profits. Even the longer journey times in the Bay Area are being welcomed as a bullish sign; according to one breathless technology executive, the drive from Berkeley to Oracle's head office on Route 101 now typically takes 70 minutes, having plunged to 50 minutes from a mid-bubble high of 100 minutes in 2000.

All that is missing is the big payday of a sought-after initial public offering (IPO). Pension funds and other institutional investors have loads of money to splurge on IPOs, yet the pipeline has so far been delivering barely a trickle of companies. Since the market got going again in mid-2003—after practically closing after the bursting of the bubble—deal volume has held steady at about 15 IPOs a month, about half the bubble-era rate, says Jay Ritter, an economist at the University of Florida. And when firms have gone public, there has been little first-day excitement. According to Mr Ritter, in the last quarter of 1999 and the first quarter of 2000, some 96 companies posted a share-price gain of at least 100% on the first day of trading; none did so during 2001-03, and only three firms have done so since—most recently in January from a spin-off of McDonald's called Chipotle Mexican Grill.

But some Valley folk detect hints of the good old bubble days in two imminent IPOs. Vonage, an internet-based phone company, last week predicted it could raise $493m, nearly double what it predicted in February when it filed to go public. It is controversially using direct-marketing to get its customers to buy its shares. Riverbed Technology, a computer-networking company, is initially hoping to raise nearly $75m. Both firms are loss-making. This is not as unusual as you might expect—44% of IPOs in 2005 featured loss-making companies, down from 80% in 2000. A much clearer indication of investors' growing appetite for risk is that both firms are very young. Vonage was founded in 2001; Riverbed rolled out its first product in 2004. According to Mr Ritter, in 1999-2000, the median age of a company at IPO was five years; in 2001-2005 it doubled to ten years, as investors looked unkindly on firms lacking a record.

As start-ups surpass revenues of $100m, the pressure on them to go public tends to grow. Employees want to cash in share options and the firm itself wants the currency of publicly traded shares in order to make acquisitions. However, the cost of complying with the Sarbanes-Oxley legislation regulating public companies—which can easily be $5m for a firm with revenues of $100m—is putting off many start-ups that would have gone for an IPO in times past.

Instead, start-ups are increasingly opting to sell themselves to a bigger company, and banking the money now rather than hanging on for a few more years in the hope of growing big enough to do an even more lucrative IPO. This holds dangers, as entrepreneurs may sell themselves short: imagine if Google's founders had accepted Microsoft's rumoured $1 billion offer a few years ago.

Indeed, whereas during the bubble entrepreneurs used to boast about the size of their IPO, now the braver ones brag about how much money they have turned down from a bidder. Today's most envied entrepreneur is Mark Zuckerburg, the Harvard drop-out who founded Facebook, a student networking firm. He is said to have recently turned down a $750m offer for his two-year-old firm from mighty Viacom.

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General Motors

Decline and fall, cont'd

May 11th 2006 | DETROIT
From The Economist print edition

Relief for the beleaguered car firm is likely to prove temporary

GENERAL MOTORS at last got some good news on May 8th. The Securities and Exchange Commission approved some accounting tweaks that turned a $323m first-quarter loss into a rare $445m profit. But GM's losses on its North American automotive operations, although halved, were still a painful $462m. And there is more bad news in the offing. A looming strike at Delphi, a bankrupt parts supplier, could have disastrous knock-on effects for GM.

The Delphi management is demanding big pay cuts from its American workforce. The United Auto Workers (UAW) union is preparing to authorise a strike should the courts approve Delphi's request to scrap its existing labour agreements. Such a move could quickly lead to parts shortages that would halt GM's American assembly lines. Even if Delphi and the union avoid a confrontation, as a New York judge considers the request over coming weeks, a settlement would probably worsen GM's weak finances. Delphi was once part of GM, which still has financial obligations to the firm. GM has already set aside about $5.5 billion to cover worker buyouts and other costs related to Delphi, but the supplier's chief executive, Steve Miller, believes billions more are needed.

Not that many years ago, GM could have handed over that sum without blinking, but its cash pile has been dwindling, even as its Japanese arch-rival, Toyota, fills a war chest—and uses it to devastating effect. On May 10th Toyota announced that it had made $12.1 billion in profits in the past fiscal year. Its stockmarket value is now 15 times that of GM—and it is taking aim at the most profitable segments of the American market, full-size pick-up trucks. GM isn't giving up without a fight. It will introduce a new version of its own full-size pickups—the Chevrolet Silverado and GMC Sierra—later this year. But while these big new models were being developed, America's petrol prices nearly doubled and consumers are turning to smaller vehicles.

GM likes to give the impression that all its woes result from the high labour, pension and healthcare costs forced on it by the unions over the years. But that burden could be borne more easily if GM had held on to the one-third share of the market it enjoyed ten years ago. Throughout the 1990s the company paid too much attention to money management and marketing rather than developing good cars.

By the time Bob Lutz, with a reputation for product development at Chrysler, was brought out of retirement to fix things, it was too late to stop the steady slide in GM's market share down to 25%. Too many GM products are still mediocre, dragged down by cheap plastic interiors. Virtually every month, despite hefty incentives, GM's market share has slipped. Outside the Midwest, the firm risks becoming irrelevant to most car buyers.

Nor can it draw much comfort from foreign operations. True, losses are ending in Europe, China is still strong and Latin America has turned around. But its grand strategy of building stakes in overseas car firms—to share parts and technology to cut costs—has proved a flop outside China,

as the stakes are sold to raise cash.

The longer GM's problems remain in the news—and the louder the murmurs grow of looming bankruptcy—the more consumers are liable to walk away. Analysts and investors seem evenly split on the possibility of GM eventually having to seek court protection from its creditors. After this week's profits restatement, GM shares bounced back by 9%. But despite the passionate assertion by Rick Wagoner, the firm's chief executive, that Chapter 11 is “not part of our strategy,” the smaller GM gets, the harder it becomes to raise money to cover its massive legacy costs. The UAW boss, Ron Gettelfinger, has ruled out any further concessions before the next bargaining round in 2007.

Mr Wagoner deserves credit for his deft paring of costs and his dogged attempts to win concessions from the unions without provoking a strike. Late last year he announced the latest in a series of cuts that will slash assembly capacity and eliminate tens of thousands of jobs. But GM is still saddled with dire pension liabilities, made only more burdensome by America's roaring inflation in employer-funded health-care costs.

In January Jerry York, the front man for Kirk Kerkorian, a billionaire investor, gave warning that GM had 1,000 days worth of cash reserves left at today's burn rate. GM now has to invest in its products and hope that it finally gives customers what they want. Some analysts reckon that restoring GM's image could take a generation. Unfortunately, the firm does not have anything like that amount of time.

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Face value

Calling Canberra

May 11th 2006
From The Economist print edition

Sol Trujillo is teaching Australia some hard lessons about modern business

Landov

AN OLD-FASHIONED red telephone box stands in the reception of Telstra's chic Sydney offices. Draped inside is a Superman costume. It is an outfit Sol Trujillo must be sorely tempted to try on right now. Since taking over as chief executive of Australia's biggest telephone operator 11 months ago, Mr Trujillo, a Mexican-American, has been trying to drag the country's telecoms industry into the 21st century. It is a challenge that might daunt even a native of the planet Krypton. Take those public phone boxes: Telstra has 31,000 of them dotted around Australia. Most are unused since 90% of the population has a mobile phone. Telstra loses A$30m ($23.2m) a year maintaining them. Yet there are howls of protest each time one is removed.

Mr Trujillo's task is to turn a former state monopoly into a modern, competitive company. But while opening Telstra's markets to competition, the government has also boxed it in with regulation. John Howard's administration expects Telstra to keep delivering a nationwide service to a population a fifteenth the size of America's, spread over almost as big a landmass. But as its main shareholder, as well as its regulator, the government also needs Telstra to keep making juicy profits—at least if it is to sell its remaining 51.8% stake for some A$25 billion this autumn, as planned. The float, which ministers said this week is still on track, would be the third-biggest share sale of all time.

Mr Trujillo is refusing to endorse these contradictory objectives. Within weeks of arriving, he told Australians that their phone company was in far worse shape than they thought—its most profitable business, fixed-line, increasingly undercut by mobile and internet telephony. “I came

here saying I would tell the truth about the condition of this company," he says. A telecoms lifer—at 32 he was the youngest executive officer in AT&T's history—Mr Trujillo, now 54, has lots of experience modernising phone companies. As the head of US West in America and Orange in Europe, he promoted new technology and products, before selling out to bigger rivals. But both the American and European markets had had 20 years or more to get used to the idea of privatisation. Australia, with just ten years' experience behind it "is still learning that governments don't have to do everything," says Mr Trujillo.

His response has been to move fast—announcing plans to cut almost a quarter of Telstra's 52,000 workforce, attacking bureaucracy and approving A$25 billion of investment over five years. He has been straight, too, about the pain—lower profits and dividends for the next two years. After that he promises growth.

But it is in his dogged battle to persuade the Australians to deregulate their markets that the small, softly spoken outsider has had to be toughest. His biggest gripe concerns a proposed $3 billion broadband fibre network to speed up Australia's painfully slow internet connections. Australia's main regulator proposes to let rival operators, such as SingTel Optus, use Telstra's new network at a low set price. Mr Trujillo is having none of it: "Those who risk capital to earn returns shouldn't have to subsidise those that don't." Worried that giving rivals a free ride would undermine his profits, Mr Trujillo is threatening not to lay the fibre: "My duty is to our shareholders—including 1.6m ordinary Australians. I will only invest where I can earn an economic return."

He argues that Australia risks emulating the "parasitic competition" that prevailed in America in the mid-1990s when the Baby Bells (such as US West) were forced to open their local networks to newer carriers. The result, he argues, was that nobody invested and America lost its global lead in broadband deployment. America, however, saw its mistake, recognised the need for scale in the telecoms industry and is now allowing mergers that amount to a recreation of the old AT&T.

Mr Trujillo reckons Australia is at least five years behind. A mish-mash of rule-setting bodies has led to lots of regulation and uncertainty. Recent comments by Helen Coonan, the communications minister, suggested future regulation of Telstra's yet-to-be-built third-generation mobile network—something no other country seeks to control. No wonder Phil Burgess, a long-time colleague of Mr Trujillo's, said he would not recommend Telstra shares to his 88-year-old mother.

Mr Trujillo's habit of hiring old colleagues from outside Australia has antagonised some. He has also recently been accused in the *Australian Financial Review* of handing out lucrative contracts to favoured suppliers, without tendering in the proper manner. But many of the attacks on Telstra's boss have been distinctly unsavoury: cartoonists have shown him astride a donkey wearing a sombrero, although his family migrated to the United States two centuries ago. Certainly his warnings and regulatory battles have pushed Telstra stock down by a quarter since his arrival, while the Australian market has risen 25%.

Yet Mr Trujillo is right to stand firm. And his opponents are wrong to characterise Telstra as a coddled monopoly. Recent analysis from Deutsche Bank shows that while the company's returns are indeed good (although already declining), they are best in unregulated or only lightly regulated businesses: telephone directories, mobile services and newer products, such as broadband access. The old copper wire, fixed-line network is in sharp decline and will earn just an 8% return by 2007, estimates Deutsche—below Telstra's cost of capital.

Beyond that, Australia needs a fast, modern telecoms infrastructure. And the quickest way to get there is to allow unfettered competition. Mr Trujillo says that America and Europe learned long ago that "to foster competition the government cannot control the levers, it must let the market work. Virtually every other country has moved towards less regulation in telecoms." If he succeeds in getting Australia to move in the same direction, that Superman costume will suit him nicely.

Google

Fuzzy maths

May 11th 2006 | SAN FRANCISCO
From The Economist print edition

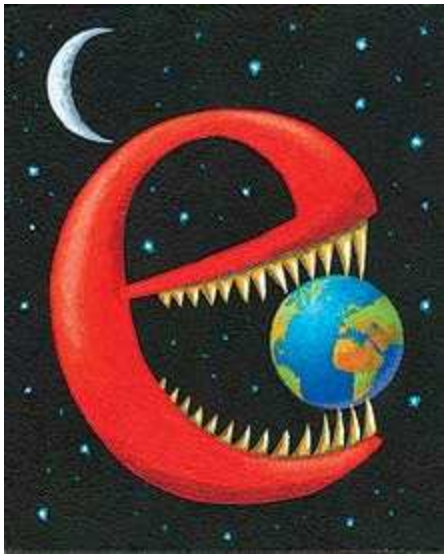
In a few short years, Google has turned from a simple and popular company into a complicated and controversial one

MATHEMATICALLY confident drivers stuck in the usual jam on highway 101 through Silicon Valley were recently able to pass time contemplating a billboard that read: "{first 10-digit prime found in consecutive digits of *e*}.com." The number in question, 7427466391, is a sequence that starts at the 101st digit of *e*, a constant that is the base of the natural logarithm. The select few who worked this out and made it to the right website then encountered a "harder" riddle. Solving it led to another web page where they were finally invited to submit their curriculum vitae.

If a billboard can capture the soul of a company, this one did, because the anonymous advertiser was Google, whose main product is the world's most popular internet search engine. With its presumptuous humour, its mathematical obsessions, its easy, arrogant belief that it is the natural home for geniuses, the billboard spoke of a company that thinks it has taken its rightful place as the leader of the technology industry, a position occupied for the past 15 years by Microsoft.

In tone, the billboard was "googley", as the firm's employees like to say. That adjective, says one spokeswoman, evokes a "humble, cosmopolitan, different, toned-down" classiness. A good demonstration of googley-ness came in the speeches at a conference in Las Vegas this year. Whereas the bosses of other technology companies welcomed the audience into the

auditorium with flashing lights and blasting rock music, Google played Bach's Brandenburg Concerto Number Three and had a thought puzzle waiting on every seat. The billboard was also googley in that, like Google's home page, it had visual simplicity that belied the sophistication of its content. To outsiders, however, googley-ness often implies audacious ambition, a missionary calling to improve the world and the equation of nerdiness with virtue.

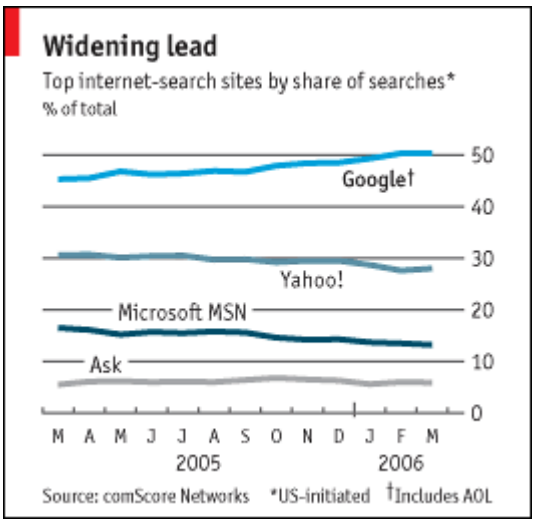


The main symptom of this, prominently displayed on the billboard, is a deification of mathematics. Google constantly leaves numerical puns and riddles for those who care to look in the right places. When it filed the regulatory documents for its stockmarket listing in 2004, it said that it planned to raise $2,718,281,828, which is $*e* billion to the nearest dollar. A year later, it filed again to sell another batch of shares—precisely 14,159,265, which represents the first eight digits after the decimal in the number *pi* (3.14159265).

The mathematics comes from the founders, Sergey Brin and Larry Page. The Russian-born Mr Brin is the son of a professor of statistics and probability and a mother who works at NASA; Mr Page is the son of two computer-science teachers. The breakthrough that made their search engine so popular was the realisation that the chaos of the internet had an implicit mathematical order. By counting, weighting and calculating the link structures between web pages, Messrs Page and Brin were able to return search results more relevant than those of any other search engine.

So far, they have maintained this superiority. Danny Sullivan, the editor of *Search Engine Watch*, an online industry newsletter, ranks Google as the best search engine, Yahoo! as second-best, Ask (the re-named Ask Jeeves) third, and Microsoft's MSN last among the big four. Google's share of searches has gone up almost every month of the past year. Including those on AOL, an internet portal that uses Google's search technology, Google had half of all searches in March. Excluding AOL, the figure was 43%. This is why people “google”—rather than, say, “yahoo”—their driving directions, dates and recipes.

Mathematical prowess is also behind the other half of Google's success: its ability to turn all those searches into money. Unlike software companies such as Microsoft which get most of their revenues from licence fees, Google is primarily an advertising agency. It does not sell the usual sort of advertising, in which an advertiser places a display on a page and pays per thousand visitor “impressions” (views): it has perfected the more efficient genre of “pay-per-click” advertising. It places little text advertisements (“sponsored links”) on a page in an order determined by auction among the advertisers. But these advertisers pay only once an internet user actually clicks on their links (thereby expressing an interest in buying). This works best on the pages of search results, which account for over half of the firm's revenues, because the users' keywords allow Google to place relevant advertisements on the page. But it also works on other web pages, such as blogs or newspaper articles, that sign up to be part of Google's “network”.



The world brain

These two interlocking “engines”—the search algorithms coupled with the advertising algorithms—are the motor that powers Google's growth in revenues ($6.1 billion last year) and profits ($1.5 billion), as well as its $117 billion market capitalisation. Its horsepower is the reason why Andy Bechtolsheim, Google's first investor (as well as a co-founder of Sun Microsystems, a big computer-maker) still holds on to all his shares in the firm. It's all about advertisers “bidding up the keywords” in Google's auctions, he says. “How far this thing could go, nobody can say.”

Since its stockmarket debut, however, Google has been adding new and often quite different products to this twin engine. It now owns Picasa, which makes software to edit digital photos on computers; Orkut, a social-networking site popular mainly in Brazil; and Blogger, which lets people start an online journal. It also offers free software for instant-messaging and internet telephony, for searching on the desktop computers of users, for (virtually) flying around the Earth, for keeping computers free of viruses, for uploading and sharing videos, and for creating web pages. It has a free e-mail program and calendar. It recently bought a firm called Writely, which lets people create and save text documents (much as Microsoft's Word does) online rather than on their own computers. Google is also scanning books in several large libraries to make them searchable. It is preparing to offer free wireless internet access in San Francisco and perhaps other cities, and dabbling in radio advertising. And that is only the start of a long list.

Whether these are arbitrary distractions or not depends on one's point of view. For Messrs Brin and Page, they make mathematical sense. Mr Brin (“the strategy guy”) has calculated that Google's engineers should spend 70% of their time on core products (ie, the search and advertising engines), 20% on relevant but tangential products, and 10% on wild fun that might or might not lead to a product. The result is that lots of tiny teams are working on all sorts of projects, the most promising ones of which end up on the prestigious “top 100” list that Mr Page (“the product guy”) spends a lot of his time on. Most of the items on that list in theory have something to do with Google's mission, which is “to organise the world's information”. Scanning and indexing books, for instance, brings offline information online.

The outside world increasingly sees it differently. Among Google fans, the company has come to epitomise the more mature (ie, post-bust) internet generation, which goes by the marketing cliché “Web 2.0” (see article). In this context, it is assumed to be working on absolutely everything simultaneously, and every new product announcement, no matter how trivial, is greeted as a tiny step toward an eventual world-changing transformation.

At a minimum, this hypothetical transformation would consist of moving computation and data off people's personal computers and on to the network—ie, Google's servers. Other names for this scenario are the “GDrive” or the “Google grid” that the company is allegedly working on, meaning free (but ultimately advertising-supported) copious online storage and possibly free internet access. Free storage threatens Microsoft, because its software dominates personal computers rather than the internet; free access threatens other internet-access providers.

At a maximum, the transformation goes quite a bit further. George Dyson, a futurist who has spent time at Google, thinks that the company ultimately intends to link all these digital synapses created by its users into what H.G. Wells, a British science-fiction writer, once called the “world brain”. Google, Mr Dyson thinks, wants to fulfil the geeks' dream of creating “artificial intelligence”. Passing the so-called “Turing test”, created by Alan Turing, a British mathematician, to determine whether a machine can be said to be able to think, would be the ultimate reward.

From primes to share prices

But many who deal with Google in their daily lives are getting fed up with such grandiose notions. Google's shares, after nearly quintupling since they began trading, have fallen in recent months. Pip Coburn, an investment strategist, says that “Google was a simple story at one point: online ads on top of the most popular search mechanism on the planet. Simple. But now it is pretty much a mess and to get the stock going again, the company may need to work on its own simplicity so as to match the simplicity of the Google home page itself.”

Mr Sullivan of *Search Engine Watch* says Google has become distracted. “Oh, give me a break,” he wrote in his blog after yet another product announcement. “A break from Google going in yet another direction when there is so much stuff they haven't finished, gotten right or need to fix.” He points to a rule in Google's corporate philosophy that “it's best to do one thing really, really well,” and suggests that the company is “doing 100 different things rather than one thing really, really well.”

Google is thus starting to look a bit as Microsoft did a decade ago, with one strength (Windows for Microsoft, search for Google) and a string of mediocre “me-too” products. Google Video, for instance, was supposed to become an online marketplace for video clips, both personal and business, but has been overtaken by YouTube, a start-up that is a few months old but already has four times as much video traffic. Google News, where the stories are, characteristically, chosen by mathematical algorithms rather than by editors, perennially lags behind Yahoo! News, with its old-fashioned human touch. Google's instant-messaging software is tiny compared with AOL's, Yahoo!'s and MSN's.

Google is beginning to resemble the old Microsoft in another way, too. A decade ago, Microsoft stood accused of stifling innovation, because entrepreneurs would stay away from any area of technology in which it showed any interest. Google, whose slogan is “Don't be evil”, hates this comparison and wants to think of itself as ventilating rather than stifling the ecosystem of developers and entrepreneurs. “I don't see how they can say that,” says an entrepreneur and competitor who is too afraid of unspecified consequences to speak on the record. Like most of Silicon Valley these days, he finds Google's slogan ridiculous, because “we're not evil either, we just don't go around saying it.”

Entrepreneurs like him are getting annoyed by Google's seemingly endless “betas”, also known as “technical previews”, when new products are not yet officially launched but available, ostensibly for testing and review. Traditionally, beta reviews were meant to last weeks or months and were targeted at testers who would find and report bugs. Google seems to use betas as dogs sprinkle trees—so that rivals know where it is. Google News recently graduated out of its beta after about four years.

In fairness, Google's role today is more complex than Microsoft's was in the 1990s, when start-ups often hoped to “exit” by listing their shares on the stockmarket, and were occasionally expunged by Microsoft before they got there. Today, start-ups (such as Writely, Picasa, Orkut and Urchin) often use Google (or the other internet titans) as the exit, selling themselves to the big guy. It works for individuals too. Paul Rademacher is a software engineer who last year came up with a clever way of combining Google's interactive maps with other websites. Google hired him.

To Google's initial surprise and subsequent chagrin (is it not enough to vow never to be evil?), it alienates more groups of people as it enters more areas of modern life. It appeared to be genuinely taken aback that some book publishers oppose its plan to scan their books and make them searchable. Google also seemed surprised when privacy advocates voiced concerns over its practice of placing advertisements in contextually related e-mail messages on its webmail service, and again this year when it announced a Chinese version that censors the search results.

Slowly, the company is realising that it is so important that it may not be able to control the

ramifications of its own actions. “As more and more data builds up in the company's disk farms,” says Edward Felten, an expert on computer privacy at Princeton University, “the temptation to be evil only increases. Even if the company itself stays non-evil, its data trove will be a massive temptation for others to do evil.” In a world of rogue employees, intruders and accidents, he says, Google could be “one or two privacy disasters away from becoming just another internet company”.

Such concerns are forcing Messrs Brin and Page, still in their early 30s, and Eric Schmidt, whom they hired as chief executive and who is in his early 50s, to behave increasingly like a “normal” company. Google recently sent its first lobbyists to Washington, DC. Its decision to build an “evil scale” to help it devise its China strategy was more unusual, but its hiring of Al Gore, a former American vice-president, to aid the process, was just the kind of thing that old-fashioned empire-building firms do all the time.

Other companies are reacting in traditional ways to Google's dominance. Former rivals, such as eBay, Yahoo! and Microsoft, are exploring alliances to counter its influence. When Microsoft tried to buy AOL from its parent, Time Warner, Google's Mr Schmidt flew in for talks that led to Google taking a defensive stake in AOL, thus keeping it out of Microsoft's and Yahoo!'s reach. In response, Microsoft has contemplated buying all or part of Yahoo!, and has recently announced a vague but large increase in research spending which amounts to an arms race. Google is now alleging that Microsoft is unfairly steering users of its web browser to MSN for searches, and is preparing to dispatch lawyers to keep Microsoft in check.

Google thus finds itself at a defining moment. There are plenty of people within the company who want it to play the power game. “The folks who are closest to Larry and Sergey are very, very worried about Microsoft, as well they should be,” says John Battelle, the author of a blog and a book on Google. Yet the company's founders themselves may not be prepared to drop their idealism and their faith in their own mathematical genius. They have always wanted to succeed by being good and doing good. “Never once did we consider buying a big company,” says David Krane, Google's 84th employee, by way of example. It would not be googley. It would, he says, be “yuck”.

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Web 2.0

The enzyme that won

May 11th 2006 | SAN FRANCISCO
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If it's cool, it's probably Web 2.0

IN 2003, towards the end of the dotcom depression, Dale Dougherty and Tim O'Reilly, the founders of O'Reilly Media, a book publisher and conference firm, were brainstorming, and Mr Dougherty dropped the term “Web 2.0”. It was an allusion to the nomenclature for software upgrades, and Mr Dougherty was applying it to what he hoped would be a second generation of the internet. “We think of ourselves as an enzyme,” says Mr O'Reilly. “When we see something coalescing, we give it a name.”

In marketing terms, it has been a great success. In 2004 Mr O'Reilly and a partner, John Battelle, started a new annual conference, called Web 2.0, which has become a big event for Silicon Valley's aristocracy. “Web 3.0” is already discussed at Web 2.0, the conference.

But what is Web 2.0? It began with a specific and useful definition. In contrast to the static web pages of the 1990s, the second wave of websites would use software (such as AJAX, or “asynchronous JavaScript and XML”) that makes web pages look like dynamic software applications that traditionally run only on personal computers. These applications, moreover, would work with one another in so-called “mash-ups”. Google Maps, for instance, is a web page that not only updates itself constantly but can also share data with other websites to yield independent web pages that display, say, crimes committed or houses for rent in an area.

At some point “Web 2.0” took on a life of its own, being applied to online social networks, collective intelligence, blogging and podcasting and “participation” in general. It started being used in sentences that also contained other buzzwords, such as the “long tail”, “folksonomies”, or the “semantic web”. It is in danger of meeting the fate of “core”, “synergy”, and “leverage”, but, for the time being, Mr O'Reilly is delighted.

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The Federal Reserve

Between bears and hawks

May 11th 2006 | WASHINGTON, DC
From The Economist print edition

The Fed has more to fear from inflation than from slower growth

Get article background

IT WOULD win no prizes for elegant prose, but the statement that accompanied the Federal Reserve's latest quarter-point increase in interest rates on May 10th was at least clear. The central bankers are not sure what to do next. “Further policy firming may yet be needed to address inflation risks,” they said, but they added that “the extent and timing of any such firming will depend importantly on the evolution of the economic outlook as implied by incoming information.”

The Fed's desire not to tie itself down is understandable. After 16 consecutive rate increases, American monetary policy is no longer loose and there are signs that areas of the economy that are sensitive to interest rates, notably the housing market, are feeling the effects of dearer money. Virtually all economists predict slower economic growth in the months ahead, a view given credence by April's surprisingly modest pace of job creation. Because higher interest rates take a while to show their full effect, prudence suggests a pause. Otherwise the central bankers risk slowing demand too sharply.

That said, the economy has hitherto been roaring along at a wholly unsustainable pace: output grew at an annualised rate of 4.8% in the first quarter of the year. Both labour and product markets are tight, global growth is looking ever stronger, commodity prices are soaring, the dollar is falling, and American inflation is already pressing against the limits of the tolerable.

The Fed's favourite measure of inflation, the annual increase in the “core” personal consumption

expenditure (PCE) deflator (ie, excluding fuel and food), rose in March to 2%—the most that Ben Bernanke, the Fed's newish chairman, feels comfortable with. On balance, the chances are that, over the next few months at least, the Fed will worry more about inflation than about slower growth.

Short-term technicalities provide one reason for this. Arithmetical nuances alone suggest that the 12-month core PCE deflator will hover around, or even exceed, 2% for a while. More important, the housing component of core inflation, which is based on rental prices, is rising.

A core inflation rate temporarily above 2% need not automatically raise red flags. It has exceeded that threshold several times in recent years. And, as economists at Goldman Sachs have pointed out, the Federal Reserve stopped raising interest rates in early 1995 and mid-2000 despite a modest rise in core inflation. Then, however, the general trend of inflation was downwards; now it is rising.

Then there are worries about Mr Bernanke's credibility. Wall Street is still getting used to the shift from Alan Greenspan. The markets may well become unusually nervous about the Fed's commitment to fighting inflation if it stops raising interest rates when core inflation is at or beyond a threshold with which Mr Bernanke himself is clearly associated.

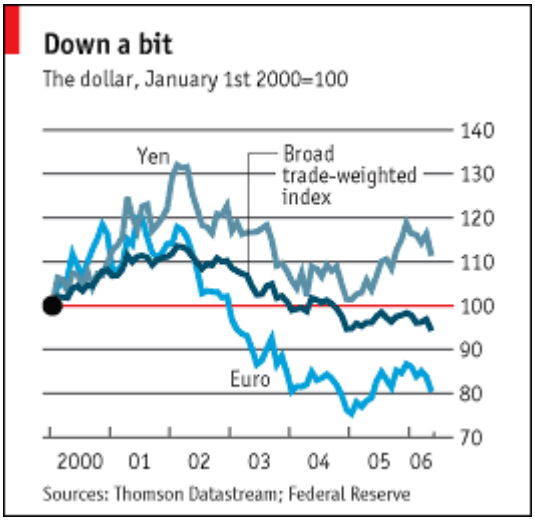
Already there are signs that people expect higher inflation to persist. According to the University of Michigan's gauge, expectations for inflation over the next five to ten years edged up to 3.1% in April, slightly higher than the average of 2.9% in 2005. The expected inflation rate implied by the prices of indexed ten-year Treasury bonds has risen by 20 basis points to 2.7% in the past five weeks. None of this is startling, but it does suggest that Americans' belief in price stability is not as firmly anchored as the central bankers might wish.

And the pressure is likely to increase. Energy prices have been rising sharply. Last year's spike in fuel prices had little effect on core consumer prices, but things are different now. America's labour markets are tighter and its firms operating more intensively. The capacity-utilisation index, a measure of firms' slack, stands at 81.3%, the tightest since 2000. The unemployment rate is at 4.7% and average hourly earnings rose by 3.8% in the year to April, up from 2.7% a year earlier.

The sanguine point out that, because profits are fat, firms need not pass higher costs on to prices. But it seems they are already doing so. Economists at JPMorgan note that companies have raised prices, as measured by the non-farm business deflator, by 3.1% in the past year, two percentage points faster than in 2003. The impact on overall core inflation has been muted, they argue, by imports of cheap consumer goods and by a temporary slowing of the prices of services, such as medical care.

Which leads to another big uncertainty in the months ahead. What impact, if any, will a falling dollar have on American inflation? After rising during 2005, the dollar seems to be heading resolutely south, in part because the interest-rate gaps between America and other countries are narrowing. Central bankers in Europe and Japan are promising tighter monetary policy even as the Fed may pause. At the same time rich-world governments are calling on China to let the yuan appreciate faster, with America to the fore. This week John Snow, the treasury secretary, said he was “extremely dissatisfied with the slow and disappointing pace”—but his department refrained from accusing China of manipulating the yuan in its semi-annual report on currencies.

On a trade-weighted basis the dollar has fallen by 3.6% since the start of the year (see chart). Given the size of America's external deficit, a further drop is likely. Less obvious is what effect this will have on inflation. In theory a falling currency implies higher import prices as foreign producers pass its effects on to their customers. But these links are much weaker than they used to be. A recent study by Fed economists found that in the late 1970s and 1980s a 10% currency depreciation would have increased import prices in G7 countries by nearly 7%. Over the past 15 years the rise would have been only 4%, and 3% in America. The impact on inflation, the study concluded, was negligible.



That suggests inflation hawks have little to fear from a gradual dollar slide. But not everyone agrees. Richard Berner, of Morgan Stanley, suggests that the pace of depreciation matters. He points out that the dollar seems to be falling faster this year than it did between 2002 and 2004 and argues that another 10% drop in its trade-weighted value could push core inflation to 2.5%. How far and fast the dollar falls will depend in part on how financial markets view Mr Bernanke's concerns about inflation. The more sanguine they think the Fed is, the faster the likely slide.

With its most recent statement, the Fed has given itself some room for manoeuvre. But the chances are that dollar bears and inflation hawks will conspire to push interest rates up.

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American banks

With open ARMs

May 11th 2006 | NEW YORK
From The Economist print edition

Wachovia embraces a good-looking California bank

BUILDING a sound marriage is no easy task. Marion and Herb Sandler, the septuagenarian co-chief executives of Golden West, a California bank, not only managed to keep together a solid one over the past 40-odd years, but also built probably the best mortgage thrift in America. Now the two are at it again. Wachovia, America's fourth-biggest bank by assets, announced on May 7th that it was buying Golden West for $25.5 billion in cash and shares, creating a bank with $669 billion in assets and branches in more than 20 states. Its investors were unimpressed. Wachovia's share price tumbled almost 7% the day after the news was announced.

Whether the doubters will be proved right is open to debate. The union moves Wachovia closer to being one of a handful of coast-to-coast banks with the size to survive in a consolidating industry dominated by giants such as Citigroup—although even after the deal, Wachovia lags far behind its bigger competitors.

Wachovia is an old hand at acquisitions. Under its former chief executive, Edward Crutchfield, it grew rapidly, if haphazardly, by gobbling up scores of banks. Its boss today, Kennedy Thompson, has been more disciplined, but no less ambitious. He headed First Union when it took over Wachovia for $14 billion in 2001 and adopted its name. Recently he led the $13.7 billion acquisition (pricey, said some) of SouthTrust, of Alabama.

Buying Golden West adds 285 branches in ten states to Wachovia's network. That gives it a substantial presence in large, fast-growing markets including Texas and, especially, California, without the hard slog of building branch networks from scratch. There are few firms with juicier businesses in California, analysts say (Washington Mutual would have been the next-best bet, but is twice the size of Golden West). The dream is to peddle Wachovia's wide range of products, such as insurance policies and credit cards, through Golden West's branches, which now offer only rudimentary services to savers.

Wachovia could hardly have picked a better-run bank. Under the Sandlers, Golden West pursued a simple strategy: it collected high-yielding deposits and lent to homebuyers through adjustable-rate mortgages (ARMs). But it also pioneered an option to borrowers to decide how much principal and interest to pay each month, with unpaid interest piling up to be repaid later. Over the past 25 years, Golden West's earnings per share have grown by a mighty 17% a year, despite the booms and busts of the mortgage cycle. It was one of the few thrifts to survive the savings-and-loan crisis of the 1980s.

The trick? The Sandlers paid rigorous attention to underwriting. “They are obsessed with credit quality,” says Ryan Batchelor of Morningstar, a research firm. He points to Golden West's use of in-house appraisers to value homes and the way it steers clear of the volatile luxury real-estate market, opting instead to lend to buyers of more modest homes (the average loan is $214,000).

They also run an extraordinarily tight ship. Costs have remained about a third of income—an industry low—for well over a decade.

The worry for Wachovia investors is that Golden West may be too good to last. Sceptics think the 15% premium paid by Wachovia is steep for a mortgage bank that may have used up its best ideas. Its innovative style of option ARMs have become the “product *du jour* for mortgage players across the spectrum,” says David Hendler of CreditSights.

On top of this, the mortgage market is cooling. The National Association of Realtors recently reported that not-yet-completed home sales fell by 6% in March compared with the same month in 2005. The Department of Commerce said that in the same month, the number of unsold homes was 24% higher than a year earlier. A slowdown would hit frothy real-estate markets like California, where Golden West has the lion's share of its core lending business, particularly hard—though Mr Batchelor points out the thrift's losses were negligible when the state's housing market crashed in the 1990s.

Meanwhile, Wachovia's intention to “cross-sell” products to Golden West's clients may not be as easy as it sounds. Because of the thrift's narrow focus, many of its customers went elsewhere for their core banking, such as paying bills and writing cheques. It's notoriously hard to convince people to switch banks.

And though Golden West has the sixth-largest volume of deposits in California, its branch network trails those of its competitors in the state. It has barely a third of the branches of its next-biggest competitor and only an eighth of Bank of America's 988, according to data compiled by SNL Financial, a research firm. Even with Golden West, Wachovia will have to spend more time and money becoming a force to be reckoned with in the state.

Perhaps the biggest question is whether Wachovia can sustain the Sandlers' golden touch. The couple declined to sign a contract to stay on, though Mr Sandler said they would remain as long as needed. Sceptics snipe that they are cashing out at the top of the market. Mr Sandler, who will be paid with Wachovia shares, called that “a bunch of garbage”. But with well over $2 billion each from the sale, surely retirement has never looked so good.

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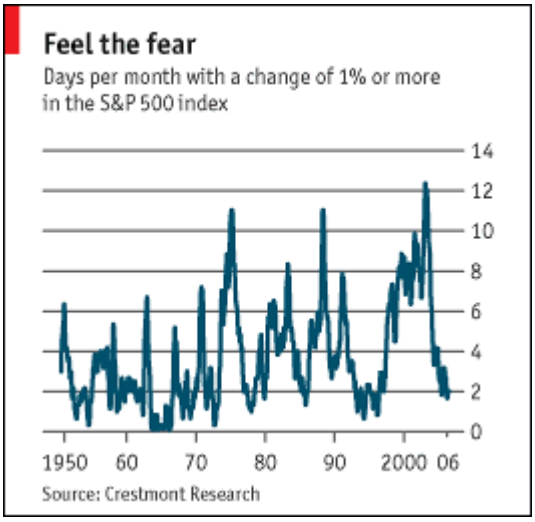
Stockmarkets

The fear gauge

May 11th 2006
From The Economist print edition

Share prices are breaking records. Are investors too complacent?



FOLLOWING the world's stockmarkets recently has been a bit like watching an act of levitation. They are serenely calm, they rise gently, and it takes faith not to worry they'll come down with a bump. This week, markets hit record highs, as measured by Morgan Stanley Capital International's broadest global index. But they did so without the stomach-churning lurches that usually characterise over-exuberance. Volatility, which measures how much asset prices fluctuate in either direction, is abnormally low. And yet, a return to the ground looks overdue.

For instance, on only eight days this year has the S&P 500 index moved by more than 1%, compared with 12 times a month in the wake of the dotcom bust, and 11 times a month during the great sell-off in the 1970s (see chart). Meanwhile, the Chicago Board Options Exchange's Volatility Index (VIX), which measures the share movements implied in stock index options, is at record lows. It predicts that the S&P 500 will move by less than 1%, up or down, over the next month.

VIX is alternatively known as the “fear gauge”, and all the signs are of an abnormally low level of anxiety among investors. There are plenty of reasons why they might feel unafraid. The world has enjoyed a long period of low inflationary growth, boringly predictable monetary policy and strong corporate earnings. Despite gently rising interest rates, there is still plenty of surplus cash to invest.

To stockmarket bears, however, low volatility is a warning sign: too much stability may, paradoxically, be destabilising. Ed Easterling of Crestmont Holdings, a Dallas investment firm, calls it “the calm before the storm”. He worries that speculators may have become overly complacent. “The current state of volatility is an indicator of potentially sharp stockmarket decline,” he says.

Episodes of extremely low volatility rarely last long, says Mr Easterling, and are usually followed by periods of exceptionally jumpy prices. There is, indeed, evidence that an increase in volatility often means a sell-off in markets.

Already, sentiment may be changing—like the corners of a picnic blanket, volatility is beginning to lift in the breeze. Currency and government-bond markets, for instance, which were placid last year, are showing signs of life, analysts say, pointing to the weaker dollar and rising American bond yields. This may reflect a growing perception of risk, as the Federal Reserve nears the top of

its tightening cycle and people scratch their heads over where interest rates are heading next.

Within American stockmarkets, there has also been a “creeping” divergence in recent weeks between the performance of shares in strong sectors, such as energy, compared with weak ones, according to Robin Carpenter, of Carpenter Analytical Services, which tracks 1,000 stocks. That may explain why hedge funds, many of which seek to arbitrage pairs of assets, have performed well: volatility creates anomalies for them to exploit.

More frequent market gyrations do not have to mean prices will fall, however. During the dotcom boom, volatility rose to quadruple the level it is now. Large one-day jumps in the Dow and other indices were regular features on the nightly news.

Chris Watling of Longview Economics, a London consultancy, says that stockmarket volatility reflects risk in the corporate sector—and has a historical correlation with corporate bond spreads, which assess the same thing. It is fair to assume risks are starting to rise. An era of corporate prudence—of restructuring balance sheets and generating cash—is giving way to a more swashbuckling appetite for acquisitions and growth. But earnings continue to grow, price/earnings multiples are attractive, and American equities remain cheap relative to bonds, Mr Watling says.

In his view, low volatility is a reflection not of complacency, but of a long period of healing in corporate America and elsewhere, which puts it in good shape to enter the next—and riskier—phase of economic growth. Fair point, but complacency is obvious only when it is too late. Nabokov put it best: “Complacency is a state of mind that exists only in retrospective: it has to be shattered before being ascertained.”

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Commodities

King copper

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Commodity prices continue to rise, but investors' tactics are changing

WEEK after week, milestones are being passed in commodity markets. The latest record-breakers are copper, which has now topped $8,000 a tonne, and platinum, now over $1,200 an ounce. Gold has surpassed $700 an ounce—its highest price in a quarter of a century. Meanwhile, bull runs in products from silver to soyabean oil continue. Investors are still pouring money into commodities—but not everyone is betting on a simple rise in prices.

In recent years the volume of copper futures traded on the New York Mercantile Exchange (NYMEX) has risen by half and that of oil has almost doubled. Much of that increase stems from the phenomenal growth in mutual funds that track commodity prices. Michael Lewis, of Deutsche Bank, estimates that the value of such funds has risen from about $20 billion in 2002 to $90 billion today.

Normally, index-tracking funds do particularly well out of commodity booms, since they profit not just from rising prices overall, but also from the difference between the price for prompt and deferred delivery. Spot prices often exceed those for goods to be delivered in the future, because buyers will pay a premium to secure their immediate needs. That allows investors to buy contracts for delivery a few months away, and hold on to them until just before they fall due, by which time they will be more valuable.

Since last year, however, oil to be delivered in the near future has cost more than that for immediate supply, eliminating this “roll return”. Indexed funds are losing money every time they trade in their maturing oil contracts for future ones. They are also losing money when they turn over their gold contracts, and returns on other metals are falling. So investors are looking for more complicated strategies to replicate their recent gains.

One tactic is to invest in more distant futures, which are still generating roll returns, or in other, more exotic instruments. Roger Diwan, of PFCEnergy, a consultancy, points out that contracts for delivery more than a year away now make up almost half of all oil futures traded, up from around 20% in 2002. Trade in options is growing even faster than that in futures, while the NYMEX alone is unveiling eight new derivatives contracts every month.

Such arcane trades have helped to attract over $50 billion in hedge-fund investment over the past three years, according to Gary Vasey of the Energy Hedge Fund Centre, a research firm. Unlike the indexed funds, he argues, such investments are not normally predicated on price rises, but on volatility. Even when speculators are betting which way the price will go, they often get it wrong—as they did by shorting oil just before Hurricane Katrina struck.

By the same token, speculators in copper, the brightest star in the commodity firmament, seem divided on its prospects. Ingrid Sternby, an analyst at Barclays Capital, notes that non-commercial

traders (meaning neither consumers nor producers of copper) were betting in roughly equal numbers for and against the recent spike in prices. The influx of new money into commodities might have magnified price movements, in her view, but it has not determined them.

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Auditors in Japan

Under attack

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A top Japanese accounting firm faces harsh penalties

ON MAY 10th the Financial Services Agency (FSA), Japan's financial regulator, imposed an unprecedented penalty on ChuoAoyama PricewaterhouseCoopers, a leading auditor. Part of PricewaterhouseCoopers, an international accounting giant, with more than 5,000 clients, including Toyota and Sony, ChuoAoyama will be barred from doing business with more than 2,000 companies, for two months starting in July. No auditor in this league has ever suffered such punishment in Japan.

The auditor's monitoring systems failed to show that its employees had been cooking the books for Kanebo, a faltering cosmetics group, for five years. Three of its employees have already admitted to criminal charges of padding Kanebo's accounts. ChuoAoyama also audited Ashikaga Bank, a large regional bank that was nationalised in 2003 after the FSA found that the bank had fiddled its accounts to hide its insolvency. Akio Okuyama, the auditor's chief director, resigned on the day the punishment was imposed.

The ban starts only in July in order to avoid chaos among the auditor's clients. This month many are expected to unveil their earnings results for the year ending March 31st 2006; next month they have shareholder meetings. ChuoAoyama will still be badly hurt, because the law requires auditors to cancel contracts with clients if their business has been suspended. Nobody knows whether these contracts will be renewed when the ban ends. This may stir memories of Arthur Andersen, which saw its American business implode as clients deserted the firm that had audited Enron. Turmoil is also expected as rival firms fight over the best clients and less desirable companies seek new auditors.

ChuoAoyama's fate will hang over an industry that has long put more effort into being chummy with its clients' managers than its clients' shareholders. Reforms in 2004 put the hitherto independent regulator, the Certified Public Accountants and Auditing Oversight Board, under the aegis of the FSA. Still, dissatisfied voices claim that the board has conflicting roles, since it acts both as a watchdog and as a representative of the accountants.

Yasuhisa Shiozaki, a politician in the ruling Liberal Democratic Party who has urged reform of auditing, wants stricter rules. “There are two tasks facing Japan,” he says: “getting rid of the elements of old-style Japanese capitalism that barely penetrated the surface, and setting up a system that prevents offences such as accounting fraud—a worldwide problem.”

One of the first steps would be to cut those intimate ties between auditors and their clients. Recent reforms require auditors to rotate client teams every seven years, with a two-year interval before they return. Swifter rotation and longer intervals might be better. Rotating accounting firms instead of internal teams would also help, but has met with fierce opposition from both politicians and accountants. Another reform proposed by Mr Shiozaki would extend criminal charges to

include accounting companies, not just employees who helped pad accounts.

Even so, the FSA has fired its first warning shot over a complacent industry. Auditors might also contemplate the fate of Koyo, once the auditor of scandal-ridden livedoor, an internet company that dressed up its books. Haemorrhaging clients, Koyo will close next month.

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Foreign-exchange trading in Japan

A yen for risk

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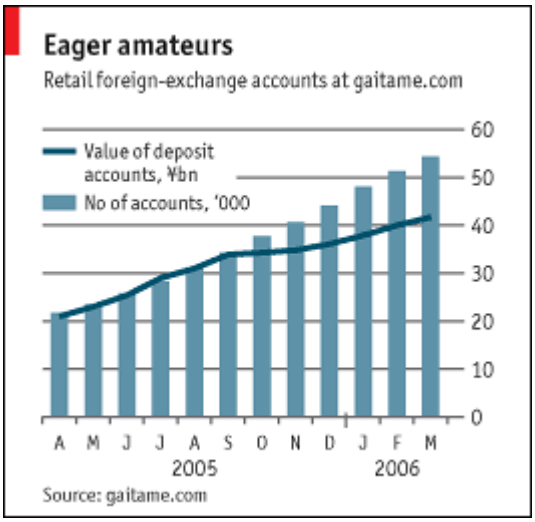
The importance of individuals in Japan's foreign-currency market

THE Japanese way of saving used to be to squirrel money away in banks and the post office, or in a cupboard at home. Years of zero interest rates have changed old habits, however, and Japanese savers have sought greater risk—notably in foreign exchange. They started with foreign-currency bank deposits, then moved on to investment trusts denominated in foreign currencies. In the past year or so, they have taken a further step, by piling into high-risk, high-return margin trading of currencies. So keen have they been that collectively they have become important actors in the yen foreign-exchange market.

Retail currency trading on margin was largely unmeasured until last year, when many intermediaries joined the Financial Futures Association of Japan (FFAJ), the industry watchdog. For the first time, the FFAJ, which does not allow members to solicit business, has been able to release figures on individuals' margin trading. In the three months to December, over-the-counter trading involving its members came to ¥33 trillion ($280 billion). Experts believe that a new trading system called click365, run by the Tokyo Futures Exchange, and trades through non-members could bring the total near to ¥40 trillion.

The size of Japan's foreign-currency market is hard to gauge, but experts put it at ¥130 trillion-200 trillion, making individuals' share 20-30%. Retail investors have, in effect, acted like mini-hedge funds, using carry trades to buy American, Australian and New Zealand dollars, euros and sterling that give them yields of up to 7%, by leveraging their principal. Gaitame.com, the top foreign-currency retail intermediary, says that on some days its retail business beats its parent broker's wholesale transactions. Gaitame.com's retail accounts have grown two-and-a-half times over the past year (see chart), a trend reflected across the industry.



Recently, the rise in the yen has dampened transaction volumes. Some traders think this will not last: while some are scrambling to cut losses, others are buying foreign currency more cheaply than before. This is a risky game with maximum leverage usually around 30 times the principal that an individual deposits. Most intermediaries block transactions when losses exceed 50-80% of the principal.

Zero interest rates are not the only reason for currency trading's sudden popularity. Shuzo Kakuta, senior forex adviser at Tokyo Tomin Bank, says that baby boomers, who are nearing retirement and have paid off their mortgages, are willing to take risks with their money. Their elders are not far behind, he adds: some rich old people are using foreign-exchange margin

deposits as masked foreign-currency savings accounts, with a juicy yield. Another reason is that foreign-currency investment trusts, now sold at banks, are becoming less alien: last year inflows amounted to ¥19.8 trillion, a sixfold rise from 2000.

Analysts are used to believing that Japan's currency is moved by banks and brokers. Yet individuals are becoming more powerful. According to the FFAJ, they held a net long position in foreign currency of ¥15 trillion at the end of 2005—almost as big as Japan's current-account surplus and more than foreigners have in Japanese stocks. Despite the strengthening yen, individuals are still selling. Mr Kakuta reckons this may continue until the central bank raises interest rates to around 3%. That's unlikely to happen soon.

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VAT fraud in the European Union

A tax net full of holes

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Europe's slow progress in combining to fight tax cheats

NO ONE knows quite how much value-added tax (VAT) the European Union loses to fraud. Loose estimates say €100 billion ($128 billion) a year. Certainly, no one thinks the problem has shrunk since May 2004, when the European Federation of Accountants (FEE) was told that that sort of sum was going missing. The European Commission has called the loss "a real worry...[that] jeopardises legitimate trade...and distorts competition."

The malady's origins lie in a 1992 decision by the Council of Ministers to stick with a nationally based system of VAT despite the advent of a single European market. Since then little progress has been made in swapping information between tax authorities. On May 17th a working group of national finance-ministry officials is due to consider the "transitional" regime. They would do well to note a commission recommendation of more than a year ago, lamenting the lack of "easy access by electronic means to all relevant information from tax and non-tax sources."

To consumers, VAT looks like a sales tax. In fact, it works by imposing a levy on the "value added" at each stage in the production of a good or service. Fraud puts lots of holes in it, from a builder's undeclared cash jobs to elaborate "carousel" fraud. This occurs when a crook acquires goods from a supplier in another EU state, then disappears without paying his share of VAT. These "missing traders" are getting more sophisticated. Mobile phones, for example, might be exported out of the EU and re-imported to a different member state just to confuse tax inspectors.

Member states are getting frustrated at the lack of progress in finding a united way of stopping cross-border fraud. At a recent conference, members of the International VAT Association, a group of companies representing VAT-paying businesses, heard that countries, including Austria, Britain, France and Germany, were now trying their own ways to stop the bleeding. Their general approach is to suggest different ways of passing all VAT liability on to the end supplier to the final consumer.

At the last count, 140 "derogations" from common European standards had been sought. These are intended to cope with a variety of scams, but mainly carousel fraud. The trouble is that these national variations threaten to force extra complexity on to exporters to the EU. Moreover, Stephen Dale, of FEE, argues that all the derogations, combined with reduced paperwork controls, could spawn other fraud, such as more cheating on corporation tax.

According to Donato Raponi, a commission official whose job is to "fight against fiscal fraud", the EU's system is basically "very good". But at present, trade data have to be passed to a trader's national tax authority only after three months and the taxman has another three months to hand them on to his counterparts across the EU. All this is "far too long". A shared database for all EU tax authorities would solve this problem.

A recent questionnaire from Brussels to national tax authorities tried to quantify the problem, but revealed little. Only Britain and Germany reported back. The Germans put their annual VAT damage at €17 billion, of which €6.8 billion was due to the black economy and €2.1 billion to carousel fraud. Britain's estimated loss in 2004-05 was £11.3 billion ($20.9 billion), up to £1.9 billion of it from carousel fraud.

Following next week's meeting, finance ministers themselves are due to gather on June 7th. They, too, ought to do what they can to improve the exchange of information among tax authorities. But few interested observers—among accountants, at least—think that they will do much.

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Economics focus

Baby boom and bust

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From The Economist print edition

Will share prices crash as baby-boomers sell their assets to pay for retirement?

MICHAEL MILKEN will celebrate his 60th birthday on July 4th. The former “junk-bond king” is still going strong, having seen off prostate cancer, and remains as controversial as ever. The debate over whether Mr Milken deserved his jail term for manipulating the high-yield bond market he largely created rumbles on nearly 20 years later, most recently during the Enron trial, where Mr Milken's genius was championed by none other than Kenneth Lay (as the saying goes, with friends like that...).

Jeremy Siegel turned 60 last November. The Wharton business school economist, whose book “Stocks for the Long Run” was the bulls' bible during the last bubble, is going strong too, trim and fit, with his mind as lively as ever—despite being called “demented” at last weekend's Berkshire Hathaway annual meeting by one of the firm's bosses, Charlie Munger. (“He's a very nice guy,” retorted the other boss, Warren Buffett.)

Mr Siegel and Mr Milken are among the first members of the post-war “baby boom” generation to enter the decade of life in which most people retire. (Mr Siegel puts the dates of America's baby-boomers at 1946-64, which he says technically makes him a pre-boomer.) Lately, both men have been giving considerable thought to what impact the impending retirement of the baby-boomers will have on the prices of financial assets. They have reached sharply different conclusions, which they aired in a conference last month at the Milken Institute.

Having built his career on arguing that buying shares and holding them is the best long-term investment strategy in almost any circumstances, Mr Siegel is now surprisingly worried about the impact on asset prices of the demographic time-bomb in the rich world represented by the baby-boomers' mass retirement. Many boomers have bought assets such as bonds and shares to fund their old age. Arguably, these purchases have helped to drive up prices over the past couple of decades. Now, he says, all else being equal, the sale of these assets will lead to a sharp fall in prices, because there are too few people in the smaller generations that followed the boomers to buy all of those assets at today's prices. For instance, in the developed world share prices could fall by as much as 40-50% over the coming decades because of boomer selling, calculates Mr Siegel. Unless they retire later, baby-boomers could see their standard of living in retirement halved, relative to their final year of work.

Mr Siegel's one great hope is that the shortfall of buyers of assets in the rich world will be made up for by a surge in demand from the developing world, as it gets richer fast thanks to the information revolution and globalisation. The demographic time-bomb of a lot of rich-country boomers having to be supported in their retirement by a smaller group of younger workers disappears when the huge, far younger population of the developing world is added to the mix. Indeed, Mr Siegel calculates that shares will continue to perform as well as they have in the past—generating real returns of above six percentage points a year since 1802, according to the

research that made his name—provided that the developing world continues to grow strongly, and that buyers there are able to snap up all the shares they want.

That would need to be a lot of shares, says Mr Siegel, who is writing a new book on the subject, “The Global Solution”. By the middle of this century, he reckons, most multinational companies would need to be owned by investors outside today's developed countries, he says, especially investors in Asia. The challenge is to integrate global capital markets so that selling assets from the old in the rich world to the young in developing countries is no harder, nor more unusual, than today's sales of assets by elderly folk in Florida to younger people in other American states. From this perspective, America's external deficits, particularly with some developing countries, may be both long-lasting and nothing to worry about.

The biggest danger is that growing protectionism in the rich world will both slow the rate of growth in the developing world and prevent its demand for shares being met. Mr Siegel views the recent opposition to purchases of American firms by companies from China and Dubai as decidedly ominous.

Milken honey

Mr Milken, by contrast, is hugely optimistic, mainly because he thinks that many boomers will live far longer than is expected today, thanks to existing medical practice and spectacular advances, such as a cure for cancer, that he expects in the near future. He thinks that average life expectancy could eventually reach 120 years. With good health at a far greater age, people will want to keep working, not retire, he says—just as he and Mr Siegel do. (This prediction, Mr Siegel notes, goes against the trend for rising average life expectancy to coincide with falling retirement ages in the rich world.)

Undaunted, Mr Milken insists that working for longer will become easier thanks to technological innovation, such as using the internet from home. That will increase wealth, fuelling demand for assets. Hence the real issue for the world over the coming decades, predicts Mr Milken, will be not whether there are enough people to buy the assets of the baby-boomers, but whether there are enough assets to buy, given all the extra demand in the world.

Most economists will tend to agree with Mr Siegel that Mr Milken's forecast is “more hope than reality”. But Mr Milken's greatest achievements, from creating the high-yield debt market to beating cancer, have been the result of his refusal to accept conventional wisdom. Perhaps he will be proved right again. And if not, there may be an ounce of good news among the bad. If politicians realise that foreign buyers are needed to prop up the value of America's retirement savings, they may be less inclined to flirt with protectionism.

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Private spaceflight

Rocket renaissance

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From The Economist print edition

The era of private spaceflight is about to dawn

Mary Evans

TWO years ago next month space travel underwent its Wright-brothers moment with the first flight of *SpaceShipOne*. The roles of Orville and Wilbur were played by Burt Rutan, who designed the craft, and Mike Melvill, who flew it—although they were ably assisted by Paul Allen, one of the founders of Microsoft, who paid for it. Of course, history never repeats itself exactly. Unlike the brothers Wright, who were heirs to a series of heroic failures when it came to powered heavier-than-air flight, Messrs Rutan and Melvill knew that manned spaceflight was possible. What they showed was that it is not just a game for governments. Private individuals can play, too.

Now, lots of people want to join in, and most of them have just met up at the International Space Development Conference in Los Angeles, to engage in that mixture of camaraderie and competition that characterises the beginnings of a new technology. And, as might be expected, they are brimming with two of the necessary ingredients of success: ideas and money.

First, the money. So far, more than $1 billion is known to have been committed to building private spaceships and the infrastructure to support them. For example, Mr Rutan's follow-up vehicle, *SpaceShipTwo*, is expected to cost its backers, Virgin Galactic, $240m for a fleet of five. The spaceport in New Mexico from which these are intended to fly will account for another $225m, although New Mexico's government is planning to raise this money itself.

These are not small sums, of course. On the other hand, Virgin Galactic has already banked $14m of deposits towards the $200,000 fare from people who want to travel on *SpaceShipTwo*, even

though it has yet to be built, let alone flown.

All this suggests that spaceflight, if not exactly entering the age of the common man, is at least entering the age of the moderately prosperous enthusiast. For entrepreneurs, it is no longer necessary to have billions of dollars to get into space; millions will now do. And for those who merely wish to travel there, and have a few hundred thousand in the bank, reality beckons—provided that at least one of the ideas actually works.

Chocks away

As with aircraft a century ago, a plethora of designs are competing with each other, and there is no certainty about which will prevail. The initial goal is to build a “suborbital” vehicle. This will not have to develop the tremendous speed needed to go into orbit around the Earth. Instead, it will travel briefly into space, offering a short thrilling ride out of the atmosphere, a few minutes of weightlessness, and a spectacular view of the planet from about 100km. Four important criteria are how you take off, what fuel you use, what your craft is made of, and how you come back.

Most people's vision of a rocket launch is straight up from the ground. But, of the five vehicles most likely to be developed (see table), two will actually be launched from the air. *SpaceShipTwo* will be carried to high altitude by a purpose-built aircraft known as *Eve* before its rocket motor is ignited. And *Explorer*, a vehicle being designed by Space Adventures, will be launched from the top of a high-altitude Russian research plane called the M-55X, according to Eric Anderson, the firm's president and chief executive.

As Dennis Jenkins, a consultant engineer at NASA, America's space agency, points out, this is similar to using a two-stage rocket to get into space, with the aircraft acting as the first stage. However, a plane offers several advantages over a throw-away booster rocket. First, it can be used again. Second, it uses oxygen from the air, rather than having to carry its own oxidant, which saves weight. Third, it is lifted by wings. That means the atmosphere is an advantage, rather than a hindrance. All this means that the spacecraft itself can be lighter and cheaper.

Not everyone wants to run two vehicles, though. Jeff Greason, president of XCOR Aerospace, a firm based in Mojave, California, is developing a two-person, ground-launched suborbital rocketplane called *Xerus*. Launching from the ground, says Mr Greason, is more difficult than air launching, but he reckons that in this case it has significantly lower operating costs.

AFP

SpaceShipOne leads the way

The second important design choice is the type of fuel. Unlike a jet engine, a rocket carries its own

oxidant. This is why it can operate in space. Sometimes that oxidant is oxygen itself, in liquid form. In that case the fuel, too, is usually liquid—either kerosene or liquid hydrogen—and the two liquids are stored in separate tanks until they meet in the rocket's combustion chamber. Alternatively, both fuel and oxidant are solid, and are loaded pre-mixed, like the propellant of a firework rocket.

SpaceShipTwo, though, follows the design of *SpaceShipOne* and is powered by a hybrid of the two. The combustion chamber of a hybrid is partly filled with solid fuel but no oxidant. However, the fuel is coated round the inside of the chamber, leaving a hole through the middle into which a liquid or gaseous oxidant can be pumped, and out of which the exhaust emerges. In *SpaceShipOne*, the fuel was rubber and the oxidant a liquefied gas called nitrous oxide.

Proponents of hybrids say they are safer than either pure solid or pure liquid rockets. George Whittinghill, Virgin Galactic's chief technologist, says that they are safer than solid rockets because the flow of oxidant can be controlled, and combustion halted, if there is a problem. Solid rockets, like the fireworks they resemble, cannot be stopped until they run out of fuel. On the other hand liquid-fuelled engines, though they can be shut down, are complex and temperamental. As Mr Whittinghill observes, “they have pumps, seals, valves and lines everywhere, and there is a lot that potentially could go wrong.”

All this rather irks those working on liquid propulsion. Richard Pournelle, head of investor relations at XCOR Aerospace, says the comparison is unfair. Liquid propulsion is routine in rocketry while hybrids are still rare. Numbers alone, therefore, mean that liquid-fuelled rockets blow up more often. That, Mr Pournelle argues, does not prove that they are inherently unsafe. Chuck Lauer, vice-president of business development for Rocketplane, another firm going down the liquid-fuelled route, agrees and argues that kerosene is widely used as aviation fuel and nobody complains that it is unsafe.

Product launches

Leading private manned spaceships

Name	Status	Finance	Seats	Launch method	Propellant
SpaceShipOne	Completed	Paul Allen	3	Air	Hybrid
SpaceShipTwo	In development	Virgin Galactic	8	Air	Hybrid
Rocketplane XP	In development	Private/state	4	Ground	Liquid
Xerus	In development	Private investors	2	Ground	Liquid
Explorer	Design	Ansari family	6	Air	*
New Shepard	In development	Jeff Bezos	*	Ground (VTOL)†	Liquid

Source: *The Economist*

*Not known †Vertical take-off and landing

Nor is safety the only issue. For, while hybrids may be cheaper to develop, they are more expensive to run. That is because they need to have new fuel-lined combustion chambers fitted after each flight. By contrast, liquid refuelling is so easy that XCOR plans that its ships will make four trips a day. In addition, according to Mr Pournelle, rubber fuel is five times more expensive than the kerosene that it and Rocketplane plan to use. Liquid fuel is also more powerful and burns more evenly.

As to what the craft are made of, composites have been the most popular choice, because they are light, strong, easy to work with and able to cope with the heat of re-entry. One notable exception, though, is Rocketplane's entry, the XP, which is an extensively converted Learjet.

At first sight, the notion of converting an executive jet into a spaceship might seem rather

dangerous. However, as Mr Lauer explains, there is very little left of the original aircraft except the fuselage. “Starting with the existing Lear gave us a frame of reference to be able to build from and saved us a year in terms of schedule,” he says. The craft has a new delta wing and a new v-tail. Wind-tunnel studies show it has “natural stability” on re-entering the atmosphere, according to Mr Lauer.

Which leads to the fourth crucial design feature: a safe landing. *SpaceShipOne* solved the problem of stability on re-entry by flipping its wings in half. Mr Lauer claims the XP's natural stability, means it has no need for such reconfiguration—though some of his critics are sceptical about this. Finally, the XP's wings, tail and nose cap are made of titanium, a heat-resistant metal, and the rest of the structure is covered with a thermal-protective paint to enable the aluminium it is made of to cope with high temperatures. The next step, says Mr Lauer, is to test the XP to destruction—to find out how and when it fails.

That leaves Blue Origin, a firm backed by Jeff Bezos, the founder of Amazon.com. Unlike everybody else's crafts, Blue Origin's *New Shepard* spaceship is designed for vertical take-off and landing (VTOL). And that is weird.

To infinity and beyond

Like the other craft under development, *New Shepard* is, according to its backers, intended for suborbital flights. However, if this is really all that Mr Bezos is interested in, a VTOL vehicle is about the most difficult way of going about it.

One way of explaining this curious design choice would be if Mr Bezos ultimately intended to produce an orbital vehicle. He wouldn't be alone. Elon Musk, a co-founder of PayPal, is hoping to do the same thing by first creating a satellite-launching business around a new, unmanned rocket, the *Falcon*. And Armadillo Aerospace, based in Mesquite, Texas, and backed by John Carmack, a rich game-designer, is tinkering with a VTOL suborbital vehicle design in the hope of building an orbital vehicle one day.

These VTOL suborbital designs might reap some monetary benefits sooner than their backers had thought. This week, while researchers were bemoaning the forthcoming slashing of NASA's scientific budget in favour of the agency's manned programme, yet more riches were coming forth for human spaceflight. A prize of $2m was announced for NASA's Lunar Lander Analogue Challenge. It will go to a vehicle with the energy and accuracy (though obviously not the overall spaceworthiness) needed to land on the surface of the moon. This will need a VTOL spaceship, which can take off, hover and land on a rocky site.

The first competition for this prize will be held in Las Cruces, New Mexico, in October this year during an event called the X-Prize cup. This is a series of about 30 rocket races that will be held on a three-dimensional track in the sky—like Formula 1 racing on steroids. It is the brainchild of Peter Diamandis, the founder of the X-Prize, a $10m purse won by *SpaceShipOne* as the first reusable suborbital vehicle. Mr Diamandis's long-term goal is for his rocket racers to race right into space. On the way to this goal, he hopes that this annual event—like the Formula 1 races which inspired it—will make a great deal of money.

He also reckons that a “Darwinian explosion” of suborbital designs is emerging. Each design, it seems, has its own merits. Several are expected to start test flights soon. Which will be first to market is unclear. Some may run out of funding. But with spaceships now costing less than a Formula 1 racing car, and having the interest of a variety of deep-pocketed investors, it shouldn't take that long.

Evolutionary psychology

Oochy woochy coochy coo

May 11th 2006
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Women can read men like books

Taxi

A GROUP of scientists has discovered that women are attracted to men who are fond of children. In years gone by, that announcement might have qualified for one of the late Senator William Proxmire's Golden Fleece awards for pointless scientific research—except that what this particular group of scientists has shown is that women can tell who is and is not fond of children just by looking at their faces.

The members of the group in question, led by James Roney of the University of California, Santa Barbara, are part of the revival of a science that once dared not speak its name—physiognomy. In the late 18th century, and during most of the 19th, it was believed that the shape of a person's head could tell you something about his character. Such deterministic thoughts fell out of favour during the 20th century. Most behavioural scientists thought that environment, not biology, shaped behaviour, and even those who did not could not see how the shape of the head or features of the face could possibly be relevant. What Dr Roney and his colleagues have found is that they are.

Their 39 male subjects, selected from a variety of ethnic backgrounds, were shown 20 pairs of pictures, each depicting an adult and an infant. They were asked to signify their preference for either the adult or the child. Some reported no interest in the child at all. The rest expressed a range of interest, including a few who always preferred the pictures of infants. The men also provided saliva swabs to assess their testosterone levels. The researchers then took digital photographs of the men and doctored the images so that their hairstyles were obscured, and could not affect the judgments of the female subjects.

These were a group of 29 women, from equally diverse backgrounds, who were shown the photographs. They were asked to rate the men according to whether they thought the men liked children, and whether those men appeared masculine and physically attractive. They were also asked to say which men they preferred for short-term and which for long-term relationships. The results, which have just been published in the *Proceedings of the Royal Society*, confirm that women are very good at reading faces.

The first part of the study provided confirmation of work done previously by other groups, using different methods. When asked to rate the men's masculinity, the women agreed on who was top and who was bottom, and their rankings correlated with the testosterone levels from the swabs. What was novel was that when asked to rate the men's liking of children from the photographs, they ranked them in the same order as the researchers had done from the interest the men themselves had shown in pictures of infants.

In physiognomic terms, the first result is easy to explain. Testosterone has multiple effects. When its production rises during puberty, it causes both body and mind to be reshaped, so it is little surprise that the former (square jaws and so on) reflect the latter (lust). But Dr Roney and his colleagues were unable to quantify what it was about the faces of the baby-friendly that signalled this attitude to women.

When asked with whom they would prefer to have a short-term relationship, women tended to pick the high-testosterone males. This makes sense from an evolutionary point of view, since testosterone suppresses the immune system. Like the proverbial peacock's tail, an excess of testosterone suggests that an individual must have particularly disease-resistant genes in order to compensate. These make desirable partners for a woman's own genes in her children. The problem with testosterone-fuelled males is that they are less likely to remain faithful to their partners.

By contrast, men who show an interest in children are also likely to make good partners, because they will care for their offspring. The study showed that women prefer these men for long-term relationships. Again, no surprise.

The surprise is this: some men were perceived both as masculine and as interested in children. From an evolutionary point of view, a trade-off between the two would have been predicted. That would produce what is known as an evolutionarily stable strategy in which the child-loving men father fewer babies to start with, but see as many live to maturity because they help to raise them rather than deserting the mothers. From the female point of view, the existence of men who are both hunky and child-friendly might seem too good to be true. For the men involved, it certainly seems like a lot of hard work.

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A new type of monkey

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MONKEYS are among the most heavily studied wild animals on Earth, and it is getting on for a century since a new group of them was last recognised by zoologists. Until now, that is. *Rungwecebus kipunji*, discovered in Tanzania last year by Tim Davenport of the New York-based Wildlife Conservation Society and his colleagues, was thought to be a type of mangabey. Examination of its genes, though, shows it is related to baboons, even though it does not look like one. As a result, it has been assigned to a genus all of its own by a paper in this week's *Science*.

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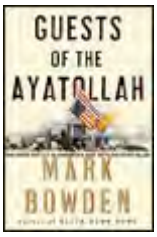
Iran and the American hostage crisis

Those were the days

May 11th 2006
From The Economist print edition

As the United Nations debates Iran's nuclear ambitions, those involved could do worse than read about an earlier round of Iran v the West

Guests of the Ayatollah: The First Battle in America's War with Militant Islam
By Mark Bowden



Atlantic Monthly Press; 704 pages; $26.
To be published in Britain by Atlantic Books in June; 464 pages; £19

Buy it at
Amazon.com
Amazon.co.uk

Rex Features

MARK BOWDEN, whose 1999 bestseller, “Black Hawk Down”, chronicled one ill-fated clash between American soldiers and Muslim renegades in the Somali capital, Mogadishu, has turned in his new book to another confrontation, one that humiliated America and destroyed President Jimmy Carter's hopes for a second term in office: the intractable stand-off more than 25 years ago in which 66 Americans were held hostage for 444 days by Islamic revolutionary students.

There is much to learn from the portrait that emerges of Iran's oil-spoiled regime, which plays by conflicting rules, prefers illusion to reality and makes grand international gestures mainly for local gain. Absurdity and hypocrisy abound. The revolutionary Iranian government allowed American diplomats to be held hostage in Tehran, yet expressed outrage when anti-Khomeini dissidents seized the Iranian embassy in London. The students who invaded the Tehran embassy told their abused American captives they expected sympathy for the hardship of being their jailers. Ironically, many of the Iranian students genuinely wanted to block what they saw as American plots against the Islamic revolution and its leadership, yet their own actions helped embolden Iraq to attack and nearly destroy their isolated country in an eight-year war.

America does not emerge well from the story. Its policymaking was blinded by wilful optimism. It believed, for instance, that it could let the sick, deposed shah into the United States for medical treatment and at the same time shore up and win over Iran's shaky transitional revolutionary government. The students' first aim had been to seek the return of the shah to face trial. When America refused to hand over its former ally and found itself unable to slake the media's frenzied thirst for something to be done to free the hostages, it lashed out with an ill-judged rescue mission.

Then, as now, Mr Bowden notes, America could expect little in the way of international support in its Middle Eastern confrontations. Canada and Sweden bravely rescued some of the Americans, but most other countries simply ignored the situation. The way Iranian minds focused when the tough-talking Ronald Reagan approached office makes one wonder what would have happened if Mr Carter had seized Iran's oil export terminal at Kharg Island right away, and used it to threaten to cause Iran—and the world—a real problem unless the hostages were released. Mr Carter believed that if he took such overt action the hostages would be murdered, yet his initial failure to confront Iran drove him in the end to launch a mission that risked their lives just the same.

As tensions rise in the current crisis, it is worth remembering that it was the1979 hostage-takers'

“year-long, televised Boston Tea Party” that tipped Iran into the Islamic-flavoured totalitarianism that defines the regime to this day. A confrontation over Iran's nuclear ambitions may prove just the tool the Iranian regime is looking for to recreate that same warm bath of popularity it enjoyed in the good old hostage-taking days.

Mr Bowden's account clarifies some issues though it breaks little new ground. He finds no absolute proof, yet he clearly believes ex-hostages' allegations that the Iranian President Mahmoud Ahmadinejad was one of the hostage-takers. Mr Ahmadinejad denies this, although he admits to being part of the inner planning group. Mr Bowden does not regard Mr Carter as weak, noting that he did not flinch from military action when political imperatives indicated there was no other way out; the rescue mission was actually aborted not by Mr Carter but by its gung-ho leading officer. Mr Bowden also collects more evidence to support the theory that Reagan's aides sought to prolong the hostage ordeal until after the 1980 presidential election. But his Iranian sources dismiss these efforts as irrelevant to their decision to postpone the release until the final departure of Mr Carter, whom they hated.

The book comes into its own when it turns in novelistic detail to the high and low points of the hostages' lives. Joe Subic, a gullible young military policeman, mostly played along with the hostage-takers, and now faces scorn for his role. Michael Metrinko, one of America's best-connected diplomats in Iran, rained vicious insults on his guards up to the last minute, and paid the price in isolation and abuse. Tom Ahern, the CIA station chief, gave a little information to his interrogators, but agonised that even that was too much. Some hostages found God, most marines taunted their kidnappers and one CIA agent in solitary confinement kept his mind sharp with intricate fantasies of flying solo and teaching a university course.

Four hundred Iranians were involved in the hostage-taking, but few make it on to the page here and those who do are usually seen through American eyes. Hamid “the Liar” wantonly toys with the hostages' hopes and Hossein Sheikh-ol-eslam interrogates with amateurish brutality. The hostage-takers' spokeswoman Nilufar Ebtekar, later a minister of environment, earns the Americans' scorn for the way her perfect English could not help her understand that a pro-Iranian uprising in the United States was never on the cards.

The biggest paradox was that the Iranians found the “den of spies” contained only four CIA officers, none of whom could speak Persian and who had almost no sources. The students found it impossible to believe that there was no American plot to kill their revolutionary leadership. “The evil dragon had turned out to be a mouse,” Mr Bowden writes. “They weren't interested in what [the CIA station chief] had actually been doing. They were interested in what they thought he was doing.”

It is easy, at times, to feel overwhelmed by the crush of conflicting points of view for Mr Bowden likes to offer up several interpretations of the same scene from both Iranian and American perspectives. There are also some odd transliterations from Persian and a confusion of “Islamism” with Iran's political goals. But Mr Bowden does a good job of describing the divergent orbits of Iran and the West. Iran's revolutionary regime seems to know it cannot survive in any kind of normal atmosphere, and America seems too vengeful to accept that Iran may have legitimate grievances over American actions in the Middle East.

The hostage crisis epitomised that divide. According to Mr Bowden, the Iranian students all believed that “the United States government was controlled by a rich Jewish cabal that acted strictly out of corrupt self-interest and often for the sheer pleasure of torturing and killing Muslims.” Unfortunately, the quarter-century of isolation since that confrontation has exacerbated, rather than reduced, the ignorance that fuelled much of the hostage-takers' youthful fanaticism.

Guests of the Ayatollah: The First Battle in America's War with Militant Islam.

By Mark Bowden.
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Caste, creed and community

Name-calling

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AMARTYA SEN is just the person to write about the politics of identity and its dangers. Identity is a tricky idea, and in the wrong hands tricky ideas can be put to wicked mischief. The guiding thought of this wise, impassioned essay is that ethnic, religious and other such labels are often treacherous, especially when someone else is labelling you at your expense. Mr Sen's target is less group loyalty itself than political and religious leaders who manipulate group claims for their own ends.

When Mr Sen says that identities are rarely simple, he himself is a walking example. Hindu by background, he is secular in outlook. Though Indian, he has worked mainly at British or American universities. He was born in 1933 in Bengal, whose eastern half has since changed nationality twice: in 1947, it became part of Pakistan and in 1971 it split off as Bangladesh, both times amid terrible communal violence. Professionally Mr Sen is also hard to pigeonhole. A Nobel-prize-winning economist, he believes in the free market but also that inequality is a problem. In argument, he credits his opponents with their best next moves, like a chess player. Yet his indignation, when he wants, can be savage.

Identity and Violence: The Illusion of Destiny
By Amartya Sen

Norton; 215 pages; $24.95.
To be published in Britain by Penguin/Allen Lane in August; £15

Buy it at
Amazon.com
Amazon.co.uk

"Identity and Violence", the latest in Norton's "Issues of Our Time" series, edited by Henry Louis Gates, opens with a concession. A standard complaint from partisans of community values or faith-based politics is that liberal individualists like Mr Sen overprize personal freedom: loyalties, that is, govern lives more than reason and choice do. So Mr Sen here repeats what he has spent much of his career saying: the rational fool of theoretical economics—the self-interested calculator with no attachments but to his or her immediate well-being—is a myth. Human allegiances—to family, friends, colleagues, city, nation, faith, knowledge, ideals, you name it—are real and essential to people's lives.

That done, Mr Sen turns to the attack. Allegiances, first, routinely jostle each other: family against work, work against ideals, ideals against community, and so on. You cannot successfully bundle them into smooth packages with a single all-purpose label, Muslim or Western, without sacrificing something of yourself that matters. Other people, by contrast, may well do that to you against your will. They may, to use Mr Sen's term, "singularise" you. Such coercive labelling is a first step towards discrimination or worse.

Next Mr Sen challenges three particular claims about attachments of caste, creed or community: that they are imposed—by birth, or however—rather than chosen; that they dominate other affiliations; and that they alone give individuals an "identity"—a sense of who they are. Together those claims add up to denying choice about the kind of person you wish to be. Mr Sen calls that denial "the illusion of destiny". You could equally well call it the refusal of personal responsibility. Mr Sen is vague at times about just who is making such claims. Yet he is wholly compelling in his

conclusion that no liberal-minded person, left or right, can accept them. If nothing else, he has drawn a line.

Much of “Identity and Violence” focuses on the Islamic world, although Mr Sen warns readers that lumping together such diverse societies by religion is already a false step: highlighting religion ignores other elements in Muslim tradition, especially science. More generally, talk of civilisations in conflict underplays diversity within traditions and interactions between them. The chapter “West and Anti-West” explores a destructive cycle of mutual stereotyping. Too few Westerners, Mr Sen complains, recognise democracy in non-Western traditions of consultation and public debate. Too many non-Westerners treat democracy and personal liberty as flawed Western idols.

Does Mr Sen see the world too much as he is: lucid, fair-minded and at ease with complexity? Perhaps he does underplay how far simplification and prejudice are willingly embraced rather than imposed. Yet whatever their source, Mr Sen knows perfectly well the harm us-and-them stereotypes can cause. When he was a boy of 11, a Muslim day-labourer ran, bleeding, into the family garden. Hindu rioters had knifed him on his way to find food for a hungry family cut off by the violence. The man died in the ambulance. “Identity and Violence” is a moving, powerful essay about the mischief of bad ideas.

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Homer

In loose-limbed English

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IN 1817, John Keats, an English poet, was so taken by an Elizabethan verse translation of “deep-browed” Homer that he published a sonnet in its honour entitled “On First Looking into Chapman's Homer”. Keats said that reading the book had given him such a combined sense of shock and uplift that he felt like “some watcher of the skies/When a new planet swims into his ken”.

Homer's Odyssey
By Simon Armitage

Faber and Faber; 266 pages; £14.99

Buy it at
Amazon.co.uk

Two centuries on, Homer's great epics, the “Iliad” and the “Odyssey”, which were written more than 2,500 years ago, are still calling forth repeated acts of homage from poets and translators. Keats was not undertaking the awe-inspiring task of endeavouring to translate Homer. He was acknowledging an imaginative debt to Homer as the creator of two of the greatest verse epics ever written.

For any translator of Homer, on the other hand, there are tricky questions, the trickiest of which may be this: should Homer be translated into poetry that tries to carry over from the Greek not only the meaning of the epic, but also some sense of the sound and the rhythm of the original? Or should the translation be in prose?

There have been fine examples of both in the 20th century. A recent verse translation of the “Iliad” by Robert Fagles, an American poet and translator, has some of the majestic, plangent music of the original. Prose versions on the other hand, even good ones, tend to be more work-a-day.

Now, a young English poet, Simon Armitage, has risen to the daunting challenge with a new version of the “Odyssey”. This is Homer in English verse, but it is verse of a pleasingly loose-limbed kind. It rhymes, but sparely, and when occasion demands. It descends, when the mood seems appropriate, into a kind of heightened prose. Above all, it feels well judged.

Mr Armitage has been important as a poet in his own right for almost two decades. His debut came in 1989 with a collection called “Zoom”. That book—slick, dead-pan, laced with a great deal of North-of-England vernacular, and aggressively opposed to any kind of smooth, self-consciously literary English—came as a breath of fresh air amid a great deal of worthy fustian.

Mr Armitage has penned a version of Homer's second epic which deals with the long-delayed homecoming of Odysseus from the Trojan wars. He was commissioned to write it as an episodic work for radio, so it is a swift, compressed and much condensed version of the 12,000-line original. Some of the heroic, lofty formalities have gone. What there is, instead, are the barest bones of the story, stripped, telescoped and re-assembled.

Mr Armitage could have turned Homer into something unrecognisable as epic poetry, something that was almost too much in love with the vernacular. Fortunately, this does not happen. He manages throughout to maintain a fine balance between the formal, and the direct freshness of human speech. His version has a kind of forceful simplicity about it. His finger remains on the pulse of plain speech, but he never overdoes it: “He's water now, or he's dust.” What could be simpler?

What comes over most clearly in Mr Armitage's version is the weft and warp of the story. And Odysseus, that god-like man who possessed “a poet's charm for bringing the past to life” through his cunning narrative skills, is always at the centre of the maelstrom: wilful, arrogant, irrepressible, indomitable—both as story-teller and man of action.

But that indomitability is only part of the cunning truth. The fact is that Odysseus is befriended by gods who want him, in the end, to succeed, in order that he may return home to his beloved wife Penelope, so long neglected, and surrounded by such a crowd of baying, bestial suitors.

It is the gods, in the end, who make it all possible. But it is also Odysseus himself, by his very example, who has seduced them into showing him such favours. Mr Armitage manages to steer deftly through all this complexity, and, almost incidentally, gives his version great life, feeling and energy.

Homer's Odyssey.
By Simon Armitage.
Faber and Faber; 266 pages; £14.99

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New cinema

The boat is upside down

May 11th 2006
From The Economist print edition

The maker of "Das Boot" turns his hand to "The Poseidon Adventure"

THE opening shot of "Poseidon" may be the most extravagant ever filmed. Beginning underwater, the camera rises up to survey the title vessel, a splendid ocean-going hotel 20 storeys tall, then descends to scrutinise the face of a man jogging on the deck. Abandoning him, it floats up and around to take in passengers lolling by the pool on the stern. The jogger reappears briefly before the viewer's omniscient eye climbs up the smokestacks and pulls back one last time to admire a beautiful sunset at sea.

Happy new year boys and girls

The only real element in this two-and-a-half-minute shot, the rest of which was created by computer, is the jogger, played by Josh Lucas, whose thespian talents take a back seat to a display of state-of-the-art movie magic in the hands of a master, Wolfgang Petersen. Mr Lucas plays a professional gambler—do they still exist?—who leads a band of passengers on the perilous journey up to the hull of the *Poseidon* after it is capsized by a rogue wave, killing everyone except those who were singing in the new year in the ballroom when nature reprogrammed the festivities.

Accompanying him are Kurt Russell as a former mayor of New York; his daughter (Emmy Rossum) and her fiancé (Mike Vogel); a lovelorn gay architect (Richard Dreyfuss) who was about to dive into the drink when he saw the 150-foot wave approaching; a single mum (Jacinda Barrett); her plucky nine-year-old (Jimmy Bennett); and a claustrophobic stowaway (Mia Maestro).

This suspenseful remake of 1972's "The Poseidon Adventure" by the man who made "Das Boot" a quarter-century ago, has no use for the kind of backstory-driven soul-searching that was once *de rigueur* in disaster films. The hero of the original was a minister who preached situation ethics, a philosophy Mr Petersen puts into practice by testing his characters' mettle in situ, leaving little

time for discussions. No sooner does a drunken lout (Kevin Dillon) start yammering about that nasty business that ended Mayor Russell's term of office than he is crushed by a falling air-conditioning unit—a fitting end to anyone silly enough to dredge up ancient history when there's a lake of fire to be traversed. We wouldn't have it any other way, and those who remember what Mr Petersen did to the heroes of “The Perfect Storm” won't even have the comfort of knowing that most of the intrepid party will survive. Maybe this time...

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Master of the furies

Thundering ivory

May 11th 2006 | FRANKFURT
From The Economist print edition

A 400-year-old mystery is at the centre of a jewel-like exhibition in Germany

A SCREAMING figure on a charging horse, carved in ivory and only 16 inches (42cm) long, is the centrepiece of an unusual exhibition of works attributed to the *Furienmeister* (master of the furies). The carver's name is not known; it is a guess that he worked in Florence, Vienna and perhaps Dresden around 1600. But there is no doubting his genius.

Elephant man

Every sinew of the horse is sprung with tension. Arteries pulse to bursting along the head and neck; even the ears are twisted by strain and speed. The fury itself, of indeterminate gender, seems to be in independent flight with its long limbs orchestrating the charge. Nothing is in proportion but everything spells forward motion.

This is mannerist art taken to extremes in an unusual medium: ivory was normally reserved for

miniatures of classical or religious sculpture. Of the 25 works scattered across Europe and America which have been attributed to the *Furienmeister*, 18 have now been brought together at the Liebieghaus in Frankfurt. One of them only just made it. As Bettina Schmitt, the curator, was visiting friends in Florence, she came across an ivory lapdog in the Palazzo Pitti and immediately recognised the hand of the master. The lapdog, with its haughty stare and one paw half-raised, is no cuddly companion—more a cockatrice whose eyes can turn you to stone.

The hallmarks of the *Furienmeister* are open-mouthed, long-limbed figures, swirling in clouds or robes that give the impression of lightness or flight. A screaming, sword-toting Marcus Curtius—also from the Pitti—is poised on his horse atop a spiral path above a galleon-like construction. The allegory defies analysis but the power is undeniable. There are more furies screaming, Hesperides feeding serpents, a phoenix, a centaur, Adam and Eve, Hercules, two androgynous figures slaying a dragon, Mars carrying off Venus attended by Cupid. All, despite their small size, have the detail and power of marble monuments.

The name *Furienmeister* was coined in the 1970s by Erwin Neumann of the Kunsthistorisches Museum in Vienna. Previously the works had been thought of as 18th century. Though the artist remains nameless, more is becoming known about his work. This is the first time so many of his sculptures have been brought together. Three, including the riding fury, belong to a reclusive German collector, Reiner Winkler, and were shown in 2001 at the Grüne Gewölbe in Dresden.

The Liebieghaus, a turreted villa on the south bank of the Main, is the perfect setting for this compact show. Visitors should not miss the museum's permanent collection, which includes “Ariadne on the Panther”, a 19th-century sculpture in Carrara marble by Johann Heinrich Dannecker, lovingly restored after fire damage in the second world war.

“The Master of the Furies” is at the Liebieghaus, Museum alter Plastik, in Frankfurt until July 9th.

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Amazon worldwide bestselling gardening books

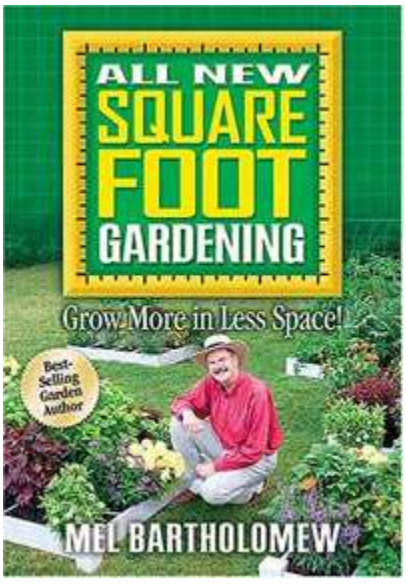
The big book index

May 11th 2006
From The Economist print edition

Dish the dirt with these horticultural gems

SPRING is the season of flowers, at least in the northern hemisphere. From China to the Czech Republic, a profusion of new colour is inspiring ambitious home horticulturists to read what the experts have to say. Then it is time to get out and dig shoots and leaves.

1. All New Square Foot Gardening.
By Mel Bartholomew. Cool Springs Press; 272 pages; $12.99



Growing large crops in small spaces by the king of the no-dig, no-weed method of horticulture.

Click to buy from Amazon.com or Amazon.co.uk

2. The Complete How to Be a Gardener.
By Alan Titchmarsh. BBC Books; 576 pages; £12

Shoots and roots demystified by the perennially popular presenter and author.

Click to buy from Amazon.co.uk

3. The Gardener's Year.
By Alan Titchmarsh. BBC Books; 312 pages; $26.40 and £11.99

A month-by-month guide to what to do in the garden, when, why—and how.

Click to buy from Amazon.com or Amazon.co.uk

4. Outside the Not So Big House: Creating the Landscape of Home.
By Julie Moir Messervy and Sarah Susanka. Taunton; 216 pages; $22.02 and £17.23

How to create indoor-outdoor spaces to match today's modern living.

Click to buy from Amazon.com or Amazon.co.uk

5. Royal Horticultural Society Encyclopedia of Plants and Flowers: The Definitive Illustrated Reference Guide.
Edited by Christopher Brickell. Dorling Kindersley; 744 pages; £20.98

The lavishly illustrated British gardening bible with information on 8,000 plants.

Click to buy from Amazon.com or Amazon.co.uk

6. First Time Gardener.
By Kim Wilde. Collins; 224 pages; $20.20 and £8.98

Kim Wilde, peroxide princess of 1980s pop turned horticulturist, tells us what gardening is all about and why it is so much fun.

Click to buy from Amazon.com or Amazon.co.uk

7. The $64 Tomato: How One Man Nearly Lost his Sanity, Spent a Fortune, and Endured an Existential Crisis in the Quest for the Perfect Garden.
By William Alexander. Algonquin; 288 pages; $14.92 and £11.31

A witty memoir proving that Mother Earth can't be controlled, especially when the beetles, worms and grubs come out to play.

Click to buy from Amazon.com or Amazon.co.uk

8. Sunset Western Garden Book.
Edited by Kathleen Norris Brenzel. Sunset Publishing; 768 pages; $20.76 and £18.21

The 50-year-old horticultural reference book for America's western states, updated with 2,000 new plant entries, climate-zone information and maps.

Click to buy from Amazon.com or Amazon.co.uk

9. The Allotment Book: A Practical Guide to Creating and Enjoying Your Own Perfect Plot.
By Andi Clevely. Collins; 224 pages; £8.98

Allotment gardening is undergoing a renaissance: this hands-on guide shows allotmenteers how to dig for victory.

Click to buy from Amazon.co.uk

10. Dirr's Hardy Trees and Shrubs: An Illustrated Encyclopedia.
By Michael A. Dirr. Timber Press; 494 pages; $44.07 and £34.48

If you can't tell your *Aesculus parvi ora* from your *Parrotia persica* then this guide to the best woody plants should have pride of place on your shelves.

Click to buy from Amazon.com or Amazon.co.uk

Global sales from Amazon.com, Amazon.co.uk, Amazon.ca, Amazon.de, Amazon.fr, Amazon.jp April 1st-April 30th 2006. Prices are correct as of May 10th.

Jane Jacobs

May 11th 2006
From The Economist print edition

Rex Features

Jane Jacobs, anatomiser of cities, died on April 24th, aged 89

AT THE age of 12, nose pressed to the window of the bus, a small, naughty girl from Scranton, Pennsylvania had her first sight of New York. There was no fanfare as she swept, on that day in 1928, out of the Holland Tunnel and into Wall Street at lunchtime, but in her mind there should have been. The density of the streets, the noise and the rush of people, astonished her. Though she did not live in New York until six years later, she had fallen in love with the complexity of city life.

At the same moment, elsewhere in the city in other people's heads, plans were incubating for something quite different. New York was to be modern, increasingly vertical, the old neighbourhoods scraped and smashed away, and bold new expressways built to speed the traffic through. Once she had settled in Greenwich Village in 1955, Jane Jacobs found herself at battle stations with Robert Moses, New York's master-builder, James Felt of the City Planning Commission, Lewis Mumford, the guru of garden cities, and various mayors. Mumford, at first encouraging, became the rudest, calling her “Mother Jacobs” and comparing her to a quack.

To Mrs Jacobs cities were living beings, functioning much like a body in which the streets were arteries and veins. They grew organically, as one sort of work differentiated into others, and the constant flow of innovation kept them alive and expanding. Bluntly (for she had a tart tongue, lubricated with cigarettes and beer), she dismissed “the primacy of agriculture” in human history. Cities had come first, as the natural eco-system of human beings, and only once the web of work and trade had reached a certain size was there any need for the help of the static, primitive and muddy countryside.

For some years her own ecosystem was centred on 555 Hudson Street, in the West Village, where

she and her family lived above a sweetshop. From there she surveyed a proper urban scene: the shopkeeper opposite hanging out his coils of wire, high-school children dropping wrappers on the street, the tailor retiring at midday to water his plants, Irish longshoremen swaying home from the White Horse Tavern. In this urban “ballet” she played her own part by leaving her keys with Joe Cornacchia at the delicatessen, taking her rubbish out to the kerb (“my little clang”) or simply watching, from the window, as everyone else went past.

This picture formed her distinctive philosophy of cities, and her clarion-call against the 20th-century wreckers. Cities should be densely peopled, since density meant safety; old buildings should rub up against new, and rich against poor; zoning should be disregarded, so that people lived where their jobs were; cars should not be banned, but walking encouraged, on pavements made wide enough for children to play. Streets should be short, so that people were obliged to experiment and explore and have the fun of turning new corners, just as she had done when hunting for jobs and apartments in her first months in New York.

Walking with Franklin

The book in which these thoughts appeared, “The Death and Life of Great American Cities” (1961), was among the most influential and controversial of the 20th century. It stopped America's urban renewal movement in its tracks, to the utter fury of Moses, Felt, Mumford and the rest. Mrs Jacobs, for all her academic-looking fringe and glasses, had no credentials save her high-school diploma, a vivid way of writing and a passion that twice got her arrested, once for incitement to riot, as she fought her victorious campaign to keep the Lower Midtown Expressway at bay. She was just a loud, determined outsider who had worked out her own ideas.

Her own ventures into urban development—six-storey walk-ups in nondescript brick, which she fought for both in New York and in Toronto, where she lived from 1968—were crisply condemned by the modernisers as “obsolete” and “unmarketable”. She was accused of nimbyism and blamed for gentrification, but no one was more disappointed than she was to discover, in the 1990s, that she could no longer afford to live on Hudson Street.

Over the years, her themes became grander: the growth of civilisations, the wealth of nations, moral behaviour, all with cities at their core. Her last book, “Dark Age Ahead”, lamented the loss of interdependence in society. Though she hated top-down planning and approved of markets, as any city-lover should, pink-tinted Canada proved more congenial both to writing and to campaigning. The government listened to her, as the rulers of New York had only ever half done.

Not just the workings of cities, but of things in general were a lasting fascination to her. In Scranton, a sooty mining town, she was miserable when the locomotives were fitted with iron skirts that hid how the wheels and pistons moved. On walks all through her life she would converse in imagination with her hero, Benjamin Franklin, explaining to that great inventor the gadgets of the modern age. “I used to tell him”, she said, “how traffic lights worked.” And doubtless, too, how vital it was to get a good crowd gathering, the cars flowing, the storemen shouting, the children playing, the whole economy expanding, from its centre in city life.

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Overview

May 11th 2006
From The Economist print edition

America's central bank raised its key interest rate from 4.75% to 5.0%, its 16th successive increase since it started tightening monetary policy in June 2004. The Federal Reserve said that further rises might be needed, but that their extent and timing would hinge on how the economic outlook develops in the light of new information.

This followed mixed signals from **America's** labour market. Non-farm payrolls rose in April by 138,000, the smallest gain in jobs since October. However, hourly-earnings growth picked up to 3.8% in the 12 months to April, the fastest since August 2001.

The **euro-area economy** expanded by 0.6% in the first quarter, leaving GDP 2.0% higher than in the same quarter a year before. This first estimate of output marks an improvement on the quarterly growth rate of 0.3% in the fourth quarter of 2005.

Despite optimistic business-confidence surveys, industrial production in **Germany** fell by 2.4% in March, the steepest monthly decline in almost six years. In **France**, on the other hand, industrial production rebounded by 1.6% in March.

In **Britain** the Bank of England sent a strong signal in its quarterly *Inflation Report* that official interest rates are heading upwards.

Stockmarkets reached all-time highs in Sydney, Vienna, Brussels and Madrid.

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Output, demand and jobs

May 11th 2006
From The Economist print edition

% change on year ago

	GDP		The Economist poll GDP forecasts		Industrial production		Retail sales (volume)		Unemployment % rate	
	latest	qtr*	2006	2007	latest		latest		latest	year ago
Australia	+ 2.7 Q4	+ 1.9	+ 3.2	+ 3.4	+ 0.6 Q4		+ 2.7 Q1		5.1 Apr	5.1
Austria	+ 2.8 Q1	+ 2.0	+ 2.2	+ 1.9	+ 6.3 Feb		+ 2.4 Feb		4.8 Apr	5.1
Belgium	+ 2.2 Q1	+ 3.2	+ 2.2	+ 1.9	+ 6.3 Feb		– 1.9 Feb		12.2 Mar†	12.6
Britain	+ 2.2 Q1	+ 2.6	+ 2.4	+ 2.5	+ 0.3 Mar		+ 2.6 Mar		5.1 Feb‡	4.8
Canada	+ 2.9 Q4	+ 2.5	+ 3.1	+ 2.8	+ 1.4 Feb		+ 4.4 Jan		6.4 Apr	6.8
Denmark	+ 3.3 Q4	– 0.1	+ 2.8	+ 2.2	+ 7.1 Mar		+ 5.4 Mar		4.8 Mar	6.0
France	+ 1.5 Q4	+ 1.4	+ 2.0	+ 2.0	+ 1.9 Mar		+ 1.6 Mar		9.5 Mar	10.1
Germany	+ 1.4 Q1	+ 1.6	+ 1.8	+ 1.2	+ 3.9 Mar		– 1.2 Mar		11.3 Apr§	11.9
Italy	+ 0.5 Q4	+ 0.1	+ 1.2	+ 1.1	+ 4.2 Mar		+ 0.1 Feb		7.7 Dec	7.9
Japan	+ 4.0 Q4	+ 5.4	+ 3.0	+ 2.4	+ 3.1 Mar		– 0.2 Feb		4.1 Mar	4.5
Netherlands	+ 2.9 Q1	+ 0.7	+ 2.5	+ 2.0	+ 2.3 Mar		+ 4.6 Feb		5.9 Mar††	6.7
Spain	+ 3.5 Q1	+ 3.2	+ 3.2	+ 2.8	+10.9 Mar		+ 1.2 Mar		8.7 Mar	9.9
Sweden	+ 2.9 Q4	+ 2.6	+ 3.4	+ 2.8	+ 0.4 Mar		+ 5.1 Mar		5.5 Mar†	6.0
Switzerland	+ 2.7 Q4	+ 2.1	+ 2.3	+ 1.8	+ 3.9 Q4		+ 0.4 Feb		3.5 Apr†	3.8
United States	+ 3.5 Q1	+ 4.8	+ 3.4	+ 2.8	+ 3.6 Mar		+ 6.2 Mar		4.7 Apr	5.1
Euro area	+ 2.0 Q1	+ 2.4	+ 2.1	+ 1.7	+ 3.2 Feb		– 0.2 Mar		8.1 Mar	8.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*									
Finland	+ 2.8 Q1	+ 1.6	na	na	+ 3.7 Mar		+ 4.5 Feb		7.9 Mar	8.3
Greece	+ 4.1 Q1	nil	na	na	+ 1.7 Mar		+ 5.9 Feb		9.7 Q4	10.4
Iceland	+ 3.6 Q4	na	na	na	na		na		1.6 Feb†	2.8
Ireland	+ 5.7 Q4	+ 7.6	na	na	– 5.2 Feb		+ 6.0 Feb		4.5 Apr	4.3
Luxembourg	+ 5.7 Q4	na	na	na	+12.7 Jan		+ 7.6 Mar		4.6 Mar	4.1
New Zealand	+ 1.9 Q4	nil	na	na	– 2.9 Q4		+ 3.0 Q4		3.6 Q4	3.6
Norway	+ 2.5 Q4	+ 1.0	na	na	+ 1.6 Mar		+ 7.7 Mar		3.9 Feb**	4.6
Portugal	+ 0.7 Q4	+ 0.4	na	na	+ 4.8 Mar		– 0.1 Mar		8.0 Q4†	7.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡Dec-Feb; claimant count rate 3.0% in Mar. §EU harmonised rate 8.7% in Mar. ††Jan-Mar. **Dec-Feb.

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Prices and wages

May 11th 2006
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2006	2007	latest		year ago	latest		year ago
Australia	+ 3.0	Q1	+ 2.4	+ 2.9	+ 2.7	+ 7.9	Q1	+ 6.0	+ 5.3	Q4	+ 2.9
Austria	+ 1.0	Mar	+ 2.9	+ 1.8	+ 1.8	+ 2.4	Apr	+ 2.6	+ 2.7	Mar	+ 2.2
Belgium	+ 2.0	Apr	+ 2.8	+ 2.1	+ 1.8	+ 4.1	Mar	+ 3.8	+ 2.3	Oct	+ 2.4
Britain	+ 1.8	Mar*	+ 1.9	+ 2.0	+ 1.9	+ 2.4	Apr	+ 3.3	+ 4.2	Feb†	+ 4.6
Canada	+ 2.2	Mar	+ 2.3	+ 2.2	+ 2.1	+ 1.1	Mar	+ 2.6	+ 0.8	Feb	+ 2.8
Denmark	+ 1.8	Apr	+ 1.8	+ 1.9	+ 1.9	+ 3.8	Mar	+ 4.2	+ 2.9	Q4	+ 2.9
France	+ 1.5	Mar	+ 1.9	+ 1.8	+ 1.5	+ 3.3	Mar	+ 3.2	+ 3.3	Q4	+ 3.0
Germany	+ 2.0	Apr	+ 1.6	+ 1.6	+ 2.3	+ 3.2	Apr	+ 3.2	+ 1.5	Feb	+ 1.2
Italy	+ 2.2	Apr	+ 1.9	+ 2.1	+ 1.8	+ 4.5	Mar	+ 4.8	+ 2.7	Mar	+ 3.5
Japan	+ 0.3	Mar	– 0.2	+ 0.4	+ 0.6	+ 2.7	Mar	+ 1.4	– 0.6	Mar	+ 1.3
Netherlands	+ 1.2	Apr	+ 1.5	+ 1.5	+ 1.5	+ 4.9	Mar	+ 5.3	+ 1.8	Apr	+ 0.5
Spain	+ 3.9	Mar	+ 3.4	+ 3.5	+ 2.9	+ 5.8	Mar	+ 5.1	+ 2.5	Q4	+ 2.7
Sweden	+ 1.5	Apr	+ 0.3	+ 1.2	+ 1.8	+ 5.1	Mar	+ 2.5	+ 2.8	Feb	+ 2.7
Switzerland	+ 1.1	Apr	+ 1.4	+ 1.1	+ 1.2	+ 1.6	Mar	+ 1.4	+ 1.0	2005	+ 0.9
United States	+ 3.4	Mar	+ 3.1	+ 3.1	+ 2.4	+ 3.5	Mar	+ 4.9	+ 3.8	Apr	+ 2.7
Euro area	+ 2.4	Apr	+ 2.1	+ 2.0	+ 2.0	+ 5.3	Mar	+ 4.2	+ 2.4	Q4	+ 2.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.9	Mar	+ 1.0	na	na	+ 5.3	Mar	+ 2.4	+ 3.5	Q4	+ 4.3
Greece	+ 3.3	Mar	+ 2.9	na	na	+ 7.8	Mar	+ 4.7	na		na
Iceland	+ 4.5	Apr	+ 4.3	na	na	+ 5.3	Apr	+ 6.6	+ 8.6	Mar	+ 6.5
Ireland	+ 3.5	Mar	+ 2.1	na	na	+ 3.6	Mar	– 2.3	+ 3.8	Q4	+ 4.6
Luxembourg	+ 3.0	Mar	+ 2.4	na	na	+ 3.9	Feb	+17.7	+ 2.5	Jan	+ 0.2
New Zealand	+ 3.3	Q1	+ 2.8	na	na	+ 6.5	Q4	+ 3.4	+ 3.3	Q1	+ 2.5
Norway	+ 2.7	Apr	+ 1.3	na	na	+20.6	Apr	+17.5	+ 3.1	Q4	+ 3.9
Portugal	+ 3.1	Mar	+ 2.2	na	na	+ 5.4	Mar	+ 4.6	nil	Feb	– 1.5

*RPI inflation rate 2.4% in Mar. †Dec-Feb.

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Economic forecasts

May 11th 2006
From The Economist print edition

The Economist poll of forecasters, May averages (previous month's, if changed)

	Real GDP, % change Low/high range		Real GDP, % change average		Consumer prices % increase		Current account % of GDP	
	2006	2007	2006	2007	2006	2007	2006	2007
Australia	2.9/3.7	2.7/3.8	3.2 (3.1)	3.4	2.9 (2.8)	2.7	-5.6(-5.5)	-5.1 (-5.0)
Austria	2.0/2.4	1.5/2.2	2.2	1.9	1.8 (1.9)	1.8	0.1	0.1
Belgium	2.0/2.6	1.6/2.2	2.2	1.9 (1.8)	2.1	1.8	2.0	2.1
Britain	1.9/2.8	2.1/2.9	2.4 (2.3)	2.5 (2.4)	2.0	1.9	-2.6(-2.5)	-2.6 (-2.5)
Canada	2.7/3.5	2.4/3.1	3.1	2.8	2.2 (2.1)	2.1	2.3 (2.2)	1.7 (1.6)
Denmark	2.5/3.3	1.7/3.1	2.8	2.2	1.9	1.9 (2.0)	2.5 (2.7)	2.3 (2.5)
France	1.7/2.4	1.6/2.4	2.0	2.0	1.8 (1.7)	1.5	-1.8(-1.6)	-1.6 (-1.3)
Germany	1.5/2.2	0.3/2.0	1.8	1.2	1.6	2.3	3.8 (3.9)	4.0 (4.1)
Italy	0.8/1.6	0.6/1.6	1.2	1.1	2.1	1.8 (1.9)	-1.6(-1.5)	-1.5 (-1.4)
Japan	2.5/3.5	1.5/3.9	3.0	2.4	0.4	0.6	3.7	3.5 (3.6)
Netherlands	1.7/3.1	1.4/2.7	2.5	2.0 (1.9)	1.5 (1.6)	1.5	5.7	5.7 (5.6)
Spain	2.8/3.7	2.4/3.1	3.2 (3.1)	2.8 (2.7)	3.5	2.9 (2.8)	-7.0(-7.3)	-6.9 (-7.4)
Sweden	2.9/4.1	2.5/3.1	3.4 (3.3)	2.8	1.2	1.8	6.4 (6.5)	6.0 (6.1)
Switzerland	2.0/2.9	1.1/2.5	2.3	1.8 (1.7)	1.1 (1.2)	1.2	13.1(13.0)	12.4 (12.3)
United States	2.8/3.7	2.4/3.3	3.4 (3.3)	2.8	3.1 (3.0)	2.4 (2.3)	-6.8	-6.7
Euro area	1.8/2.4	1.3/2.4	2.1	1.7	2.0	2.0	-0.3	-0.1

Sources: ABN AMRO, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, JPMorgan Chase, Morgan Stanley, Decision Economics, BNP Paribas, Royal Bank of Canada, Citigroup, Scotiabank, UBS

Each month *The Economist* surveys a group of forecasters and calculates the average of their predictions for economic growth, inflation and current-account balances in 15 countries and the euro area. The table also shows the highest and lowest projections for growth. The previous month's figures, where they are different, are shown in brackets. The panel has raised its forecast for America's growth this year to 3.4%, up from 3.3% predicted in April. It expects Britain to grow slightly faster this year (2.4%, up from 2.3%) and next (2.5%, compared with a forecast of 2.4% in April). The soothsayers remain divided about the prospects in Japan and Germany. The most optimistic among them think Japan might grow by as much as 3.9% next year, and Germany might grow by 2.0%. Others think growth might be as low as 1.5% in Japan and 0.3% in Germany.

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Money and interest rates

May 11th 2006
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (May 10th 2006)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+10.4	+ 9.1	Mar	5.88	5.69	5.73	5.82	5.40	6.84
Britain	+ 6.7	+12.3	Mar	4.66	4.84	4.71	4.68	4.50	5.11
Canada	+11.7	+ 6.8	Mar	4.09	2.47	4.13	4.51	4.23	5.61
Denmark	+18.3	+16.9	Mar	2.95	2.18	3.54	4.00	3.38	5.37
Japan	+ 5.0	+ 1.5	Mar	0.05	0.02	0.80	2.00	1.30	2.04
Sweden	- 0.5	+10.9	Mar	2.12	1.91	2.96	3.85	3.36	3.69
Switzerland	+ 1.6	+ 4.7	Mar	1.41	0.76	1.93	2.75	2.01	2.66
United States	+ 0.8	+ 4.7	Mar‡	5.13	3.15	4.99	5.12	4.22	6.11
Euro area†	+10.1	+ 8.6	Mar	2.88	2.13	3.41	3.96	3.33	4.48

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. ‡New series for broad money supply. Benchmarks: US 30-year 5.19%, Japan No. 279 1.99%. Central bank rates: US fed funds 5.00%, ECB refinancing 2.50%, BOJ overnight call 0.001%, BOE repo 4.5%. Sources:Bank of Canada, Commerzbank, Danske Bank, Global Insight, JPMorgan Chase, Stockholmsbörsen, UBS, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

May 11th 2006
From The Economist print edition

2000=100

	May 2nd	May 9th*	% change on one month	% change on one year
Dollar index				
All items	173.8	178.1	+ 9.6	+34.4
Food	137.4	137.4	+ 1.7	+ 7.7
Industrials				
All	220.8	230.7	+16.6	+66.0
Nfa†	151.0	152.8	+ 2.6	+19.3
Metals	258.8	273.2	+21.7	+88.5
Sterling index				
All items	143.2	145.0	+ 2.8	+35.9
Euro index				
All items	127.1	128.7	+ 3.9	+35.2
Yen index				
All items	182.5	182.8	+ 2.2	+40.8
Gold				
$ per oz	664.50	696.25	+16.2	+62.8
West Texas Intermediate				
$ per barrel	74.54	70.56	+ 2.4	+36.0

*Provisional. †Non-food agriculturals.

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Stockmarkets

May 11th 2006
From The Economist print edition

Market indices

	May 10th	2006 high	2006 low	% change on one week	% change on record high	% change on Dec 30th 2005 in local currency	% change on Dec 30th 2005 in $ terms
Australia (All Ordinaries)	5,305.3	5,305.3	4,708.8	+ 1.5	nil	+12.7	+19.1
Austria (ATX)	4,295.7	4,344.4	3,682.4	+ 0.9	- 1.1	+17.1	+27.1
Belgium (Bel 20)	3,966.6	3,987.3	3,573.9	+ 1.0	- 0.5	+11.8	+21.2
Britain (FTSE 100)	6,083.4	6,132.7	5,618.8	+ 1.2	- 12.2	+ 8.3	+17.5
Canada (Toronto Composite)	12,316.3	12,487.3	11,272.3	+ 1.0	- 1.4	+ 9.3	+15.9
Denmark (OMXCB)	391.0	395.5	362.0	+ 3.3	- 1.1	+ 6.3	+15.3
France (SBF 250)	3,735.8	3,755.6	3,327.6	+ 1.8	- 14.9	+13.2	+22.8
France (CAC 40)	5,278.3	5,312.2	4,748.3	+ 1.6	- 23.8	+11.9	+21.4
Germany (DAX)*	6,118.4	6,140.7	5,334.3	+ 2.5	- 24.1	+13.1	+22.7
Italy (S&P/MIB)	38,642.0	38,765.0	35,652.0	+ 1.9	- 22.9	+ 8.2	+17.4
Japan (Nikkei 225)	16,951.9	17,563.4	15,341.2	- 1.2	- 56.4	+ 5.2	+12.3
Japan (Topix)	1,725.1	1,783.7	1,572.1	- 0.7	- 40.2	+ 4.6	+11.6
Netherlands (AEX)	469.1	478.0	431.5	+ 1.0	- 33.1	+ 7.4	+16.5
Spain (Madrid SE)	1,317.7	1,318.5	1,156.8	+ 1.8	- 0.1	+14.0	+23.6
Sweden (Affarsvarlden Gen)	330.5	333.7	287.3	+ 1.0	- 17.4	+12.6	+23.0
Switzerland (Swiss Market)	8,112.9	8,122.1	7,583.9	+ 1.9	- 3.6	+ 7.0	+15.6
United States (DJIA)	11,642.7	11,642.7	10,667.4	+ 2.1	- 0.7	+ 8.6	+ 8.6
United States (S&P 500)	1,322.9	1,325.8	1,248.3	+ 1.1	- 13.4	+ 6.0	+ 6.0
United States (NASDAQ Comp)	2,320.7	2,370.9	2,205.3	+ 0.7	- 54.0	+ 5.2	+ 5.2
Europe (FTSEurofirst 300)†	1,397.1	1,405.6	1,277.1	+ 1.3	- 18.1	+ 9.5	+18.8
Euro area (FTSE Euro 100)†	1,191.9	1,198.7	1,078.9	+ 1.3	- 23.1	+ 9.4	+18.7
World (MSCI)‡	1,402.5	1,406.3	1,259.1	+ 1.8	- 3.2	+11.5	+11.5
World bond market (Citigroup)††	642.5	642.5	612.1	+ 1.4	- 3.6	+ 3.6	+ 3.6

*Total return index. †In euro terms. ‡Morgan Stanley Capital International Index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

May 11th 2006
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		Current-account balance % of GDP, forecast 2006	Current-account balance % of GDP, forecast 2007	Exchange rate trade-weighted† 2000=100 May 10th	Exchange rate trade-weighted† 2000=100 year ago	Currency units per $ May 10th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2005‡
Australia	− 12.4	Mar	− 42.1	Q4	− 5.6	− 5.1	118.7	115.7	1.29	1.29	2.40	1.65	1.17	+ 1.0
Austria	− 2.0	Feb	+ 0.5	Dec	+ 0.1	+ 0.1	104.8§	105.8	0.78	0.78	1.46	–	0.71	− 2.0
Belgium	+ 12.3	Feb	+ 6.6	Dec	+ 2.0	+ 2.1	106.4§	107.7	0.78	0.78	1.46	–	0.71	nil
Britain	−123.0	Mar	− 57.4	Q4	− 2.6	− 2.6	99.7	100.5	0.54	0.53	–	0.69	0.49	− 3.1
Canada	+ 59.9	Feb	+ 25.2	Q4	+ 2.3	+ 1.7	130.4	114.7	1.10	1.25	2.05	1.41	1.00	+ 1.3
Denmark	+ 8.9	Mar	+ 6.1	Mar	+ 2.5	+ 2.3	106.4	106.4	5.83	5.81	10.9	7.46	5.27	+ 2.8
France	− 30.3	Feb	− 43.5	Feb	− 1.8	− 1.6	107.1§	108.6	0.78	0.78	1.46	–	0.71	− 3.2
Germany	+191.5	Mar	+108.4	Mar	+ 3.8	+ 4.0	108.5§	110.2	0.78	0.78	1.46	–	0.71	− 3.9
Italy	− 16.3	Feb	− 28.5	Feb	− 1.6	− 1.5	106.7§	108.1	0.78	0.78	1.46	–	0.71	− 4.3
Japan	+ 86.5	Feb	+163.4	Feb	+ 3.7	+ 3.5	84.6	88.7	111	106	206	142	–	− 6.5
Netherlands	+ 39.1	Feb	+ 39.8	Q4	+ 5.7	+ 5.7	107.2§	108.5	0.78	0.78	1.46	–	0.71	− 1.6
Spain	− 98.8	Feb	− 82.3	Jan	− 7.0	− 6.9	105.1§	106.0	0.78	0.78	1.46	–	0.71	+ 0.3
Sweden	+ 19.3	Mar	+ 21.8	Q4	+ 6.4	+ 6.0	96.9	98.1	7.29	7.19	13.6	9.33	6.59	+ 1.2
Switzerland	+ 7.5	Mar	+ 50.2	Q4	+13.1	+12.4	106.7	107.5	1.22	1.21	2.27	1.56	1.10	− 1.6
United States	−798.3	Feb	−804.9	Q4	− 6.8	− 6.7	81.8	83.1	–	–	1.86	1.28	0.90	− 3.7
Euro area	+ 10.8	Feb	− 39.1	Feb	− 0.3	− 0.1	118.3	117.5	0.78	0.78	1.46	–	0.71	− 2.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 9.5	Feb	+ 4.2	Feb	na	na	107.9§	109.2	0.78	0.78	1.46	–	0.71	+ 2.1
Greece	− 35.0	Feb	− 19.6	Feb	na	na	104.1§	104.9	0.78	0.78	1.46	–	0.71	− 4.5
Iceland	− 1.7	Mar	− 2.6	Q4	na	na	106.2**	98.2	69.9	65.2	130	89.4	63.2	+ 2.0
Ireland	+ 38.9	Feb	− 3.9	Q4	na	na	111.7§	114.2	0.78	0.78	1.46	–	0.71	− 0.9
Luxembourg	− 4.8	Feb	+ 3.6	Q4	na	na	106.4§	107.7	0.78	0.78	1.46	–	0.71	− 2.3
New Zealand	− 4.8	Mar	− 9.6	Q4	na	na	120.3	138.6	1.59	1.37	2.97	2.04	1.44	+ 5.3
Norway	+ 51.1	Mar	+ 49.5	Q4	na	na	113.1	108.4	6.08	6.31	11.3	7.78	5.49	+ 15.3
Portugal	− 23.1	Feb	− 17.1	Feb	na	na	105.1**	106.6	0.78	0.78	1.46	–	0.71	− 6.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, February average. ‡OECD estimate. **IMF, December average.

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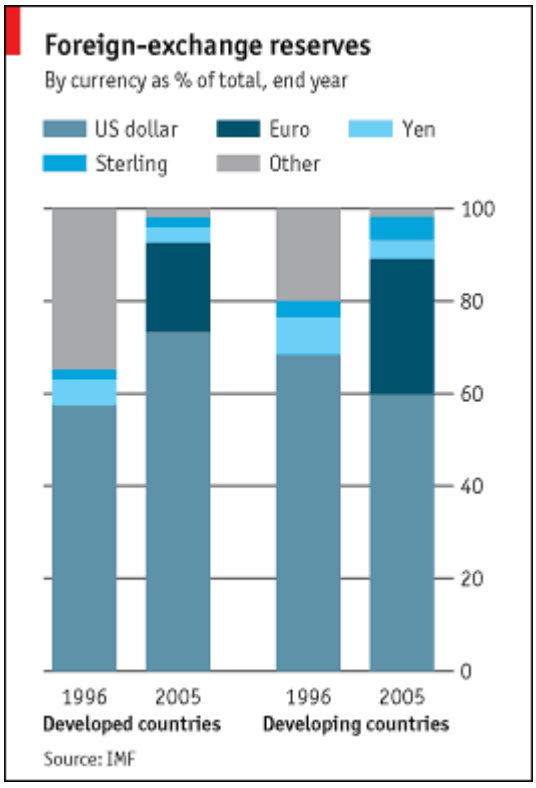
Foreign-exchange reserves

May 11th 2006
From The Economist print edition



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Overview

May 11th 2006
From The Economist print edition

Saudi Arabia's stockmarket collapsed, losing a quarter of its value in a week. Share prices in **Egypt** fell by 7%.

Brazil's 12-month rate of inflation fell to 4.6% in April, compared with 5.3% in March.

Taiwan's exports amounted to almost $18.8 billion in April, a record. Its exports of electronic goods rose by 31.8% compared with the same month a year earlier.

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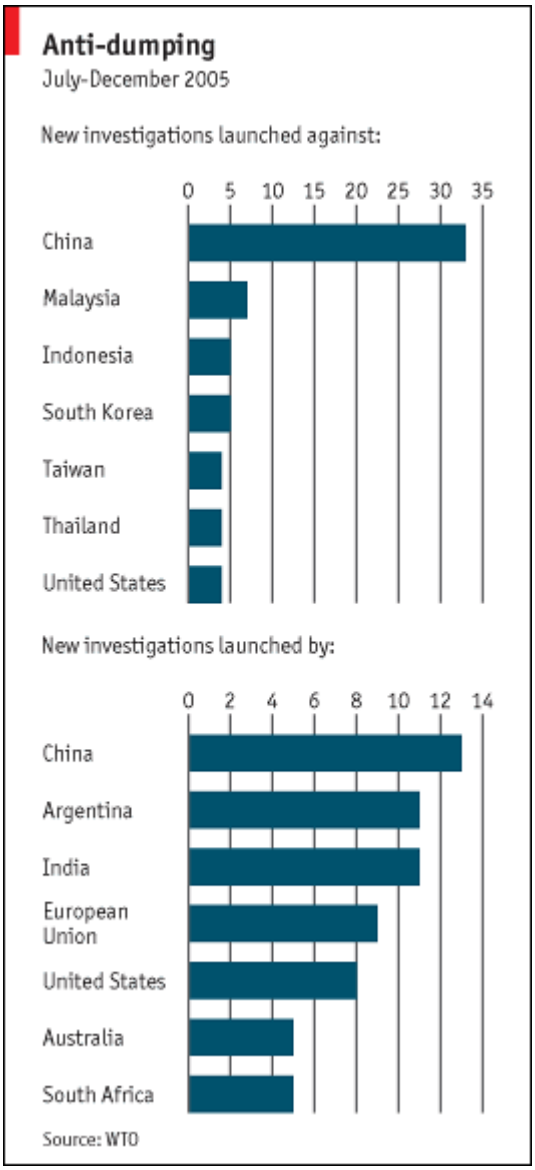
Anti-dumping

May 11th 2006
From The Economist print edition

A country that sells its goods abroad for less than they cost to produce, or for less than they fetch at home, might expect gratitude from its trading partners. More often, it is accused of “dumping”. China faced 33 such allegations between July and December 2005, according to the World Trade Organisation (WTO), far more than any other country. Not all of these investigations will result in retaliation, but some will. WTO members slapped 22 anti-dumping duties on China's products in the second half of 2005, for example. Accused of dumping on others, China is also dumped on itself. It launched 13 anti-dumping investigations, more than any other country, in the latter half of 2005.



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Economy

May 11th 2006
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+10.2	Q1	+17.8	Mar	+ 0.8	Mar	+108.1	Mar	+160.8	2005	875.1	Mar
Hong Kong	+ 7.6	Q4	+ 5.9	Q4	+ 1.8	Mar	−11.9	Mar	+19.7	Q4	127.0	Apr
India	+ 7.6	Q4	+ 8.8	Feb	+ 5.0	Feb	−39.4	Mar	−13.3	Q4	153.6	Apr
Indonesia	+ 4.9	Q4	−17.5	Feb	+15.4	Apr	+30.5	Mar	+ 3.0	Q4	33.8	Feb
Malaysia	+ 5.2	Q4	+ 3.6	Mar	+ 4.8	Mar	+26.7	Mar	+19.9	Q4	73.1	Mar
Pakistan	+ 8.4	2005†	+19.3	Sep	+ 6.9	Mar	−10.5	Mar	− 3.7	Q4	10.9	Mar
Philippines	+ 6.1	Q4	−11.8	Feb	+ 7.1	Apr	− 3.8	Feb	+ 2.4	Dec	17.9	Apr
Singapore	+ 9.1	Q1	+25.2	Mar	+ 1.2	Mar	+32.5	Mar	+33.2	Q4	127.9	Apr
South Korea	+ 6.2	Q1	+10.0	Mar	+ 2.0	Apr	+18.8	Apr	+ 9.6	Mar	217.3	Mar
Taiwan	+ 6.4	Q4	+ 7.2	Mar	+ 1.2	Apr	+10.4	Apr	+16.4	Q4	259.0	Apr
Thailand	+ 4.7	Q4	+ 8.2	Mar	+ 6.0	Apr	− 5.9	Mar	− 0.7	Mar	53.7	Mar
Argentina	+ 9.1	Q4	+ 3.7	Mar	+11.6	Apr	+11.2	Mar	+ 5.4	Q4	19.6	Feb
Brazil	+ 1.4	Q4	+ 5.2	Mar	+ 4.6	Apr	+45.0	Apr	+13.3	Mar	59.2	Mar
Chile	+ 5.8	Q4	+ 7.6	Mar	+ 3.7	Apr	+12.1	Apr	+ 0.7	Q4	16.0	Mar
Colombia	+ 3.7	Q4	+ 5.6	Feb	+ 4.1	Apr	+ 1.4	Jan	− 1.9	Q4	14.9	Apr
Mexico	+ 2.7	Q4	+ 5.4	Feb	+ 3.2	Apr	− 4.9	Mar	− 5.7	Q4	76.0	Mar
Peru	+ 4.9	Feb	+ 3.6	Feb	+ 2.9	Apr	+ 5.2	Feb	+ 1.0	Q4	13.4	Mar
Venezuela	+10.2	Q4	+13.6	Jan	+11.4	Apr	+31.5	Q4	+25.4	Q4	22.5	Feb
Egypt	+ 4.9	2005‡	+ 4.0	2005†	+ 3.2	Mar	−11.1	Q4	+ 2.2	Q4	22.0	Apr
Israel	+ 4.8	Q4	+ 8.9	Feb	+ 3.6	Mar	− 8.6	Mar	+ 2.4	Q4	28.0	Apr
Saudi Arabia	+ 6.2	2005‡	na		+ 1.6	Feb	+84.6	2004	+90.7	2005	28.1	Mar
South Africa	+ 4.5	Q4	+ 3.8	Feb	+ 3.4	Mar	− 5.0	Mar	−10.1	Q4	21.3	Apr
Czech Republic	+ 6.9	Q4	+11.8	Feb	+ 2.8	Apr	+ 1.7	Mar	− 2.6	Q4	30.2	Apr
Hungary	+ 4.3	Q4	+11.3	Mar	+ 2.3	Apr	− 3.4	Mar	− 8.0	Q4	21.5	Mar
Poland	+ 4.2	Q4	+16.4	Mar	+ 0.4	Mar	− 2.6	Feb	− 4.0	Feb	42.3	Mar
Russia	+ 7.0	Q4	+ 4.1	Mar	+10.0	Apr	+129.9	Mar	+84.3	Q1	205.9	Mar
Turkey	+ 9.5	Q4	+ 8.9	Mar	+ 8.8	Apr	−45.8	Mar	−25.5	Mar	56.5	Feb
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+11.1	Q4	+ 6.8	Mar	+ 4.3	Apr	− 2.6	Feb	− 1.5	Feb	1.9	Mar
Latvia	+10.5	Q4	+ 9.9	Mar	+ 6.1	Apr	− 3.2	Feb	− 2.1	Feb	2.5	Mar
Lithuania	+ 8.1	Q1	na		+ 3.5	Apr	− 4.0	Mar	− 1.8	Feb	3.9	Mar
Slovakia	+ 7.6	Q4	+15.3	Mar	+ 4.5	Apr	− 2.8	Mar	− 4.2	Jan	15.9	Feb
Slovenia	+ 5.1	Q4	+ 9.9	Mar	+ 2.7	Apr	− 1.7	Mar	− 0.3	Feb	8.3	Feb

*Excluding gold, except Singapore and China; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

Financial markets

May 11th 2006
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	May 10th		Dec 30th 2005	
	May 10th	year ago	May 10th	% a year		one week	in local currency	in $ terms
China	8.00	8.28	14.9	2.34	1,622.6	+7.3	+ 32.9	+ 34.0
Hong Kong	7.75	7.80	14.4	4.50	17,080.6	+0.3	+ 14.8	+ 14.8
India	44.9	43.2	83.7	5.72	12,612.4	+2.5	+ 34.2	+ 34.5
Indonesia	8,722	9,458	16,254	13.21	1,539.4	+2.7	+ 32.4	+ 49.4
Malaysia	3.58	3.80	6.67	3.77	966.6	+1.7	+ 7.4	+ 13.4
Pakistan	60.1	59.5	112	9.43	11,571.9	-1.3	+ 21.1	+ 20.5
Philippines	51.5	54.2	95.9	7.75	2,529.5	+8.1	+ 20.7	+ 24.3
Singapore	1.56	1.64	2.92	3.44	2,642.9	-0.6	+ 12.6	+ 19.7
South Korea	929	1,003	1,732	4.37	1,451.1	+1.1	+ 5.2	+ 14.4
Taiwan	31.3	31.2	58.4	1.70	7,324.7	+1.1	+ 11.9	+ 17.3
Thailand	37.6	39.4	70.1	5.25	784.3	+1.3	+ 9.9	+ 19.8
Argentina	3.04	2.89	5.67	9.75	1,896.2	+2.2	+ 22.9	+ 22.3
Brazil	2.05	2.48	3.82	15.77	41,751.0	+2.0	+ 24.8	+ 42.0
Chile	513	577	956	4.80	10,250.9	+0.9	+ 11.3	+ 11.2
Colombia	2,331	2,338	4,344	5.91	10,750.9	- 1.9	+ 13.0	+ 10.9
Mexico	10.8	11.0	20.2	7.02	21,781.1	+2.9	+ 22.3	+ 20.2
Peru	3.28	3.25	6.11	4.45	7,612.8	+8.7	+ 58.5	+ 65.8
Venezuela	2,552§	2,711§	4,755	10.55	31,136.3	+0.7	+ 52.7	+ 54.7
Egypt	5.76	5.80	10.73	8.63	53,754.4	- 7.1	- 2.9	- 3.3
Israel	4.43	4.37	8.25	5.35	916.9	+2.9	+ 10.7	+ 15.2
Saudi Arabia	3.75	3.75	6.99	4.94	9,750.0	-25.3	- 41.7	- 41.7
South Africa	6.04	6.18	11.2	7.15	22,024.0	+3.1	+ 21.7	+ 27.9
Czech Republic	22.1	23.4	41.2	2.13	1,535.4	+4.2	+ 4.2	+ 16.2
Hungary	204	195	380	6.13	25,145.8	+0.7	+ 21.0	+ 27.1
Poland	3.00	3.24	5.58	4.16	44,798.1	+1.7	+ 25.8	+ 36.8
Russia	27.0	27.9	50.3	12.00	1,739.9‡	+0.9	+ 45.3	+ 54.6
Turkey	1.35	1.37	2.52	14.00	43,599.0	- 2.3	+ 9.6	+ 9.6
EM (MSCI)*	1.00	1.00	1.86	na	879.3	+2.2	+ 24.5	+ 24.5
EMBI+†	1.00	1.00	1.86	na	374.5	+0.1	+ 1.6	+ 1.6

*Emerging Mkts. †JPMorgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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